71-327 71-328

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IN THE

Supreme Court of the United States

October Term, 1971

Docket No. .....

TEXAS GULF SULPHUR COMPANY, a Texas Corporation, CHARLES F. FOGARTY, RICHARD D. MOLLISON, RICHARD H. CLAYTON, WALTER HOLYK, KENNETH H. DARKE, DAVID M. CRAWFORD, CLAUDE O. STEPHENS, EARL L. HUNTINGTON and HAROLD B. KLINE,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

APPENDICES

INDEX TO APPENDICES

PAGE

Appendix A

Opinion of the District Court (Dated August 16, 1966) 1a

Judgment of the District Court (Entered August 22, 1966) 64a

Opinion of the Court of Appeals (Decided August 13, 1968) 66a

Judgment of the Court of Appeals (Entered August 13, 1968) 172a

Second Opinion of the District Court (Dated February 6, 1970) 175a

Second Judgment of the District Court (Entered April 16, 1970) 215a

Second Opinion of the Court of Appeals (Decided June 10, 1971) 220a

Second Judgment of the Court of Appeals (Entered June 10, 1971) 234a

Appendix B

Constitutional Provisions, Statutes and Rules Involved 235a

APPENDIX A

Opinion of the District Court

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

65 Civ. 1182

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

against

TEXAS GULF SULPHUR COMPANY, a Texas corporation, CHARLES F. FOGARTY, RICHARD D. MOLLISON, RICHARD H. CLAYTON, WALTER HOLYK, KENNETH H. DARKE, DAVID M CRAWFORD, THOMAS S. LAMONT, FRANCIS G. COATES, CLAUDE O. STEPHENS, THOMAS P. O'NEILL, JOHN A. MURRAY, EARL L. HUNTINGTON and HAROLD B. KLINE,

Defendants.

(5436) BONSAL, D. J.

Plaintiff, Securities and Exchange Commission (Commission), has instituted this action charging each of the defendants with violations of Section 10(b) of the Securities Exchange Act (15 U.S.C. 78j(b)) and Rule 10b-5 (17 C.F.R. 240; 10b-5) promulgated thereunder by the Commission. All parties waived a jury and agreed that trial should first be had on the issue of whether the defendants or any of them had violated Section 10(b) and Rule 10b-5, reserving for later hearing the issue of the remedy to be applied in the event such violations are found.

The Commission's action arises out of the exploratory activities of defendant Texas Gulf Sulphur Company (TGS) on the Kidd 55 segment near Timmins, Ontario, between November 12, 1963 and April 16, 1964. TGS is (5437) alleged to have violated Section 10(b) and Rule 10b-5 by issuing a false press release regarding these activities on April 12, 1964. Each of the individual defendants was a director, officer or employee of TGS. Individual defendants who purchased stock or calls on stock of TGS between November 12, 1963 and April 16, 1964, or recommended such purchases to others, are charged with violations of Section 10(b) and Rule 10b-5 on the ground that they used to their own advantage material information as to TGS's exploratory activities on the Kidd 55 segment, which material information had not been disclosed to or absorbed by the stockholders or the public. Five of the individual defendants who accepted stock options granted on February 20, 1964 are charged with violations of Section 10(b) and Rule 10b-5 on the ground that they

were in possession of such material information which they used to their own advantage by failing to disclose it to the Directors' Committee which granted the stock options.[1]

TEXAS GULF SULPHUR COMPANY (TGS)

In 1963 64 TGS (which was organized in 1909) was the world's largest supplier of sulphur. Its authorized capital stock was 15,000,000 shares, without par value. (5438) 11,520,000 shares had been issued (including 1,504,101 shares held in the Company's treasury). On December 31, 1963, there were issued and outstanding in the hands of the public in excess of 10,000,000 shares held by some 65,000 shareholders. The stock of TGS was listed on the New York Stock Exchange and was admitted to unlisted trading privileges on the Midwest Stock Exchange. TGS's total assets, less current liabilities, had a book value of over $169,000,000 as of December 31, 1963, and over $210,000,000 as of December 31, 1964. The stockholders' equity was stated to be in excess of $129,000,000 as of December 31, 1963, and in excess of $137,000,000 as of December 31, 1964. Its annual sales were in excess of $62,000,000 for 1963 and in excess of $70,000,000 for 1964. Its working capital was approximately $47,000,000 as of December 31, 1963, and approximately $87,000,000 as of December 31, 1964. Its earnings per share for the period 1960-1964 were:

1960	1961	1962	1963	1964
$1.27	$1.26	$1.21	$0.93	$1.15

From 1955 to 1963 TGS's annual sales declined from $93,000,000 in 1955 to $62,000,000 in 1963 and its (5439) annual earnings from $32,000,000 in 1955 to $9,300,000 in 1963. This decline was attributed by TGS to the oversupply of sulphur, resulting in depressed prices during the period.

The market price of TGS stock on the New York Stock Exchange declined from a high of $45 a share in 1955 to a low of $11 a share in 1962. In 1963 the price rose from 13¾ in March to 19⅜ in November and to 21⅞ at the end of the year. In 1964 the price rose from a low of 21⅛ in January to a high of 30¼ on April 15. On April 16, the day of TGS's public announcement of the Kidd mine, the price rose from a low of 30⅛ to a high of 37, closing at 36⅜. The price continued to rise during the balance of April 1964 to a high of 58⅜ on April 30, on which day the stock closed at 54¾.

Between 1956 and 1963, despite a growth in the demand for sulphur, the price per ton of sulphur declined from around $28 in 1956 to under $20 in 1963. However, by late 1963 the turn-around had been reached. Sulphur became in short supply, and on April 1, 1964 TGS announced a $2 per ton increase in the price. TGS's gross sales for (5440) 1963 were the highest in four years, up 5.56% from 1962.

TGS's 1963 earnings were adversely affected by the mysterious loss of the S.S. MARINE SULPHUR QUEEN early in that year. In January 1964 TGS put into service a larger liquid sulphur cargo vessel to replace the lost vessel and announced the launching of the world's largest liquid sulphur tanker, which would make it possible to ship liquid sulphur to Europe, and on February 8, 1964 it announced plans to increase its Canadian production of sulphur by 500 tons per day.

Apart from its primary sulphur business, TGS was engaged in a diversification program in other fields, such as phosphate, potash, trona, oil and gas. Its entry into the phosphate and potash fields was important because phosphate, potash and sulphur are the three basic components of fertilizers. On November 15, 1963, TGS announced the creation of a new division for its phosphate project and that its potash mine was near completion and was scheduled

to go into production in the spring of 1964. On December 16, 1963, TGS announced that it had acquired the Canadian oil and gas properties of Delhi-Taylor Oil Company, and on April 3, 1964 announced plans (5441) to proceed with a 3,000,000 ton-per-year phosphate program in North Carolina at a cost of $45,000,000.

TGS had been engaged in exploration for sulphide deposits on the Canadian Shield since 1957 and in 1963-64 undertook exploratory work on the Kidd 55 segment in Kidd Township near Timmins, Ontario, which is more fully described hereafter.

The Individual Defendants

The individual defendants are directors, officers and employees of TGS as follows:

Defendant	Position
Claude O. Stephens	President and Director
Charles F. Fogarty	Executive Vice President* and Director
Thomas S. Lamont	Director
Francis G. Coates	Director
Harold B. Kline	Vice President and General Counsel**
Richard D. Mollison	Vice President
David M. Crawford	Secretary***
Richard H. Clayton	Engineer
Walter Holyk	Chief Geologist
Kenneth H. Darke	Geologist
Earl L. Huntington	Attorney
John A. Murray	Office Manager

* Prior to February 20, 1964 Mr. Fogarty was Senior Vice President.

** Prior to January 31, 1964 Mr. Kline was Vice President-Administration and Secretary.

*** Mr. Crawford was employed by TGS in January 1964 and became Secretary on February 20, 1964.

(5442) Defendant Thomas P. O'Neill was an accountant with TGS. He was served with a summons and complaint, but has failed to answer or appear. The Commission has moved for a default judgment against O'Neill in a separate proceeding. Therefore he is not referred to hereafter.

Summary of TGS's Exploratory Activities on the Kidd 55 Segment

Exploration on the Canadian Shield:

In 1957 TGS initiated an exploration program for sulphides[2] on the Canadian Shield, a vast area comprising most of eastern Canada. Much of the area is barren and flat with few outcroppings of rock and is covered with a swampy material known as muskeg. The subsurface structure consists of Pre-Cambrian rocks, dating from an early geologic time, and is complex and distorted.

(5443) Beginning in March, 1959, an exploration group—headed by defendant Mollison, a mining engineer, and consisting of defendant Holyk, the chief geologist; defendant Clayton, an electrical engineer and geophysicist; and defendant Darke, a geologist—conducted aerial geophysical surveys over more than 15,000 miles of the Canadian Shield area. Sulphides conduct electricity better than most other rock types and can be detected if they are in sufficient quantity and concentration and are not too deeply buried beneath the earth's surface.[3]

In the course of this aerial exploration, TGS detected several thousand anomalies—unusual variations in the conductivity of rocks. In the opinion of the exploration group several hundred of these anomalies were (5444) worthy of further investigation, and rights to land around them were

acquired. One of these anomalies, detected as early as 1959, was located near Timmins, Ontario, and was designated as the Kidd 55 segment. On June 6, 1963, TGS acquired an option to purchase the northeast quarter section (160 acres) of the Kidd 55 segment. Between November 8, 1963 and April 16, 1964 TGS drilled K-55-1, K-55-3, K-55-4, K-55-5, K-55-6, K-55-7 and K-55-10 at the locations shown on the accompanying Plan Map of the Kidd 55 segment.

Drill Hole K-55-1

On October 29 and 30, 1963, defendant Clayton conducted a ground geophysical survey on the northeast quarter section which confirmed the existence of the anomaly previously detected by the aerial survey. Defendant Clayton interpreted the survey as indicating three separate conductors of electricity tending in a north-south direction with an undetermined width and steep dip. Since the survey only indicated the presence of conductive material and not whether the material consisted of worthless or valuable minerals and since there was little geological evidence as to the makeup of the subsurface structure (the (5446) nearest outcroppings of rock were located more than 1,000 feet from the property), diamond core drilling was necessary for

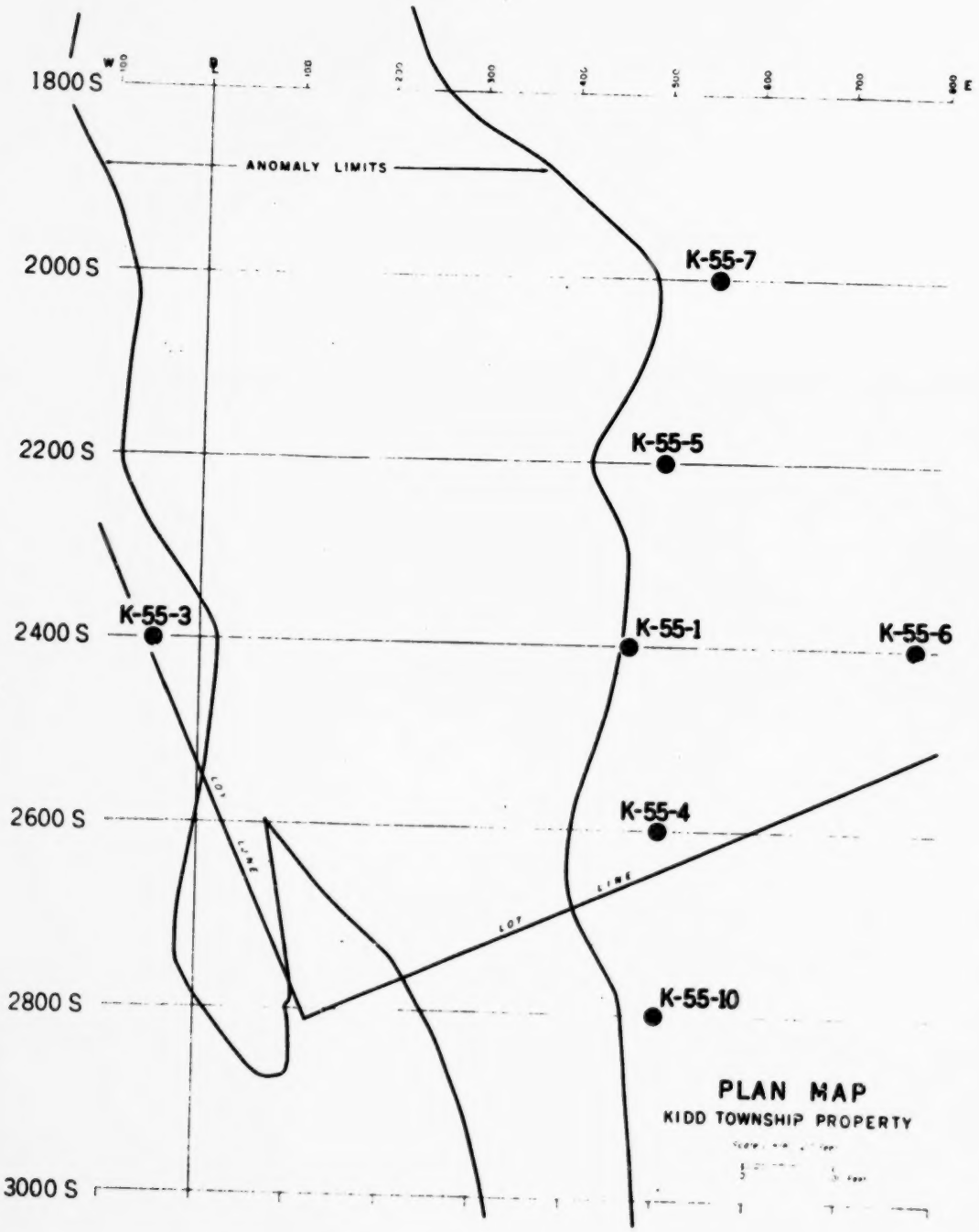
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(5445)

Plan Map

KIDD TOWNSHIP PROPERTY

PHOTOPRINT
(Mounted Opposite)


1800 S
2000 S
2200 S
2400 S
2600 S
2800 S
3000 S
ANOMALY LIMITS
K-55-7
K-55-5
K-55-3
K-55-1
K-55-6
K-55-4
K-55-10
LOT LINE
LOT LINE
PLAN MAP
KIDD TOWNSHIP PROPERTY

further evaluation of the anomaly. TGS had previously drilled 65 equally promising anomalies, but most of them had revealed either barren pyrite or graphite, while a few had shown marginal mineral deposits in insufficient quantities to be commercially mined.

On November 8, 1963, drilling of the initial hole (K-55-1) was begun on section line 2400 S. The location, direction, and angle of the hole were determined by defendants Holyk, Clayton and Darke, who considered the results of the geophysical survey and the location of property boundaries. The collar of the hole was placed about 60 feet to the east of the easternmost conductor, as interpreted by defendant Clayton, and at the strongest part of the anomaly. The hole was drilled westerly at an angle of 60 degrees in the hope that it would cut through all three conductors.

On November 12, 1963, drilling of K-55-1 was terminated at 655 feet. Defendant Holyk visually estimated that the core of K-55-1 indicated an average copper content of 1.15% and an average zinc content of 8.64% over a length of 599 feet. The percentages of copper and zinc (5447) mineralization at any given point in the core fluctuated markedly, but the copper mineralization appeared to be concentrated more on the eastern edge of the anomaly.

Property Acquisition

As a result of the visual examination of the core, TGS determined to acquire the three other quarter sections making up the Kidd 55 segment. Therefore, following the usual practice in the mining industry, security measures were put into effect. Further drilling on the anomaly was suspended and members of the exploration group were instructed to keep the results of K-55-1 confidential. The drill rig at the site of K-55-1 was moved away and cut sap-

lings were stuck in the ground in the area of the hole to conceal its location. A second drill hole (K-55-2) was drilled off the anomaly in order to produce a barren core.

The core from K-55-1 was split longitudinally and shipped to the Union Assay House, Salt Lake City, Utah, for chemical assay. In mid-December, TGS received reports from the assay which revealed an average metal content of approximately 1.18% copper and 8.26% zinc, as well as 3.94 ounces of silver per ton over a 602-foot length of the core. These were the only chemical assay reports on any drill hole which TGS received prior to April 16, 1964.

(5448) In the meantime, negotiations for the three other quarter sections comprising the Kidd 55 segment had been undertaken. TGS purchased one quarter-section outright for $7,500 and acquired options for $7,000 to purchase the other two for approximately $45,000. On March 27, TGS decided that the land acquisition program had advanced sufficiently to permit the company to resume drilling.

Drill Hole K-55-3

On March 31, the drilling of K-55-3 was commenced on section line 2400 S approximately 75 feet west of the western limits of the anomaly and approximately 510 feet west of K-55-1. It was drilled easterly at an angle of 45 degrees, and therefore crossed K-55-1 in a vertical plane on section 2400 S. K-55-3 was completed by 7:00 p.m. on April 7 and visual estimates of the core indicated an average copper content of 1.12% and an average zinc content of 7.93% over 641 feet of the hole's 876-foot length. Like K-55-1, K-55-3 indicated substantial copper mineralization on the eastern edge of the anomaly. Daily reports of the progress of K-55-3 and of the subsequent drill holes were made by defendants Mollison and Holyk to defendants Stephens and Fogarty.

(5449) *Drill Hole K-55-4*

On April 7, drilling of K-55-4 was commenced slightly to the east of the eastern edge of the anomaly on section line 2600 S, 200 feet to the south of K-55-1, and was drilled westerly on an angle of 45 degrees, parallel to K-55-1. By 7:00 p.m. on April 9, K-55-4 had encountered mineralization over 366 feet of its 420-foot length, but had entered a stretch of barren material at the 420-foot mark. The hole was completed to a length of 579 feet on April 10 at 7:00 p.m. without encountering further mineralization. Visual estimates of the 366 feet of mineralized core recovered from K-55-4 indicated an average copper content of 1.14% and an average zinc content of 8.24%. Like K-55-1 and K-55-3, K-55-4 encountered substantial copper mineralization on the eastern edge of the anomaly.

Drill Holes K-55-6 and K-55-5

On April 8, drilling of K-55-6 was commenced with a second drill rig[4] on section 2400 S, 300 feet to the east of K-55-1. It was drilled westerly at an angle of 60 degrees and was intended to explore mineralization beneath hole K-55-1. Due to the absence of geologists from the drill site on April 8 and 9,[5] no immediate visual estimates of the core were available. It was apparent, (5450) however, by the evening of April 10 that the hole had encountered substantial copper mineralization over the last 127 feet of its 569-foot length.

On April 10, drilling of K-55-5 was commenced with a third drill rig on section 2200 S, 200 feet north of K-55-1. The hole was started on the eastern edge of the anomaly and was drilled westerly at an angle of 45 degrees, parallel to the holes previously drilled. By the evening of April 10, K-55-5 had been drilled 97 feet and, although no immediate visual estimates of the core were available, it was apparent

that the hole had intersected substantial copper mineralization over the last 42 feet of its length.

The results of drilling through the evening of April 10 were available to TGS when it issued its April 12 press release.

Core Drilling between 7:00 p.m. April 10 and 7:00 a.m. April 13

Drilling of K-55-5 and K-55-6 continued, and by the morning of April 13, K-55-5 had encountered mineralization to the 580-foot mark. It was subsequently drilled to a length of 757 feet without encountering further mineralization. Visual estimates of the core indicated that over a 525-foot section the drill hole had intersected an average (5451) copper mineralization of 0.82% and an average zinc mineralization of 4.2%. By 7:00 a.m. on April 13, K-55-6 had encountered mineralization to the 946-foot mark. It was subsequently drilled to a length of 1180 feet without intersecting any further mineralization. Visual estimates of a 504-foot section of the core indicated an average copper content of 1.72% and an average zinc content of 6.60%.

On April 12 drilling of K-55-7 was commenced with a fourth drill rig on section 2000 S at the eastern edge of the anomaly. It was drilled westerly at an angle of 45 degrees and by the morning of April 13 had encountered 50 feet of mineralization over the 137 feet drilled. The drilling of a mill test hole, K-55-8, was also commenced by April 11 and completed by the evening of April 13. The core was 2¼ inches in diameter as compared with the 1⅛ inch diameters of the other holes, and was intended to be used for metallurgical testing to determine the amenability to milling of the material that had been encountered. No geologist's log or visual estimates were made of K-55-8 and no metallurgical tests of the core were reported prior to April 16.

(5452) *Core Drilling between 7:00 a.m. April 13 and 7:00 p.m. April 15*

On April 14 drilling of K-55-10 was commenced on section 2800 S on the eastern edge of the anomaly and was drilled westerly at an angle of 45 degrees. By 7:00 p.m. on April 15, it had encountered mineralization over the last 231 feet of the 249 feet of drilling. Drilling of K-55-7 was completed to a length of 707 feet, but encountered only 26 more feet of mineralization between the 425-foot and the 451-foot marks.

Purchase of TGS Stock and Calls on TGS Stock by Certain Defendants and "Tippees" between November 12, 1963 and April 16, 1964

The evidence established that all of the individual defendants except Stephens and Kline purchased shares of TGS and/or calls on TGS stock between November 12,
(5453) 1963, when the first drill hole on the Kidd property was completed (K-55-1), and the close of business on April 16, 1964, the day on which TGS issued a press release announcing the discovery of a copper mine on the Kidd 55 segment at a press conference called for the purpose. The evidence also shows that certain persons who were referred to by counsel at the trial as "tippees" purchased shares of TGS and/or calls on TGS stock on the basis of advice received directly or indirectly from defendants Darke, Coates and Lamont. The following table lists these purchases (including those of defendant Holyk's wife), but does not include the shares covered by stock options granted by TGS to certain defendants on February 20, 1964.

Purchase Date	Purchaser	Shares		Calls	
		Number	Price	Number	Exercise Price
HOLE K-55-1 COMPLETED NOVEMBER 12, 1963					
1963					
Nov 12	Fogarty	300	17¾-18		
15	Clayton	200	17¾		
15	Fogarty	700	17⅝-17⅞		
15	Mollison	100	17⅞		
19	Fogarty	500	18⅛		
26	Fogarty	200	17¾		
29	Holyk (Mrs.)	50	18		
CHEMICAL ASSAYS OF DRILL CORE OF K-55-1 RECEIVED DECEMBER 9-13, 1963					
Dec 10	Holyk (Mrs.)	100	20⅜		
12	Holyk (or wife)			200	21
13	Mollison	100	21⅛		
30	Caskey*			300	22¼
30	Fogarty	200	22		
31	Fogarty	100	23¼		
1964					
Jan 6	Holyk (or wife)			100	23⅝
8	Murray			400	23¼
16	Westreich*	2000	21¼-21¾		
24	Holyk (or wife)			200	22¼-22⅜
Feb 10	Fogarty	300	22⅛-22¼		
17	Atkinson*	50	23¼	200	23⅛
17	Westreich*	50	23¼	1000	23¼-23⅝
20	Darke	300	24⅛		
24	Clayton	400	23⅞		
24	Holyk (or wife)			200	24⅛
24	Miller*			200	23¾
25	Miller*			300	23⅝-23½
26	Holyk (or wife)			200	23⅜
26	Huntington	50	23¼		
27	Darke (Moran as nominee)			1000	22⅝-22¾
Mar 2	Holyk (Mrs.)	200	22⅜		
3	Clayton	100	22¼		
3	E. W. Darke*			500	22½-22⅝
16	Huntington			100	22⅜
16	Holyk (or wife)			300	23¼
17	Holyk (Mrs.)	100	23⅞		
17	E. W. Darke*			200	23⅜
23	Darke			1000	24¾
26	Clayton	200	25		

Purchase Date	Purchaser	Shares Number	Shares Price	Calls Number	Calls Exercise Price
LAND ACQUISITION COMPLETED MARCH 27, 1964					
Mar 30	Atkinson*			400	25¾-25⅞
30	Caskey*	100	25⅞	1000	25¾-25⅞
30	Darke			1000	25½
30	E. W. Darke*			200	25½
30	Holyk (Mrs.)	100	25⅞		
30-31	Klotz*			2000	25½-26⅛
30	Miller*			500	25½-25⅞
30	Westreich*	500	25¾		
CORE DRILLING OF KIDD 55 SEGMENT RESUMED MARCH 31, 1964					
Apr 1	Clayton	60	26½		
1	Fogarty	400	26½		
2	Clayton	100	26⅞		
6	Fogarty	400	28⅛-28⅞		
8	Mollison (Mrs.)	100	28⅛		
421 FEET KIDD-55-4 COMPLETED APRIL 9, 1964, 7 P.M.					
TGS PRESS RELEASE ISSUED APRIL 12, 1964					
Apr 15	Clayton	200	29⅜		
16	Crawford (and wife)	600	30⅛-30¼		
TGS PRESS RELEASE AND PRESS CONFERENCE APRIL 16, 1964, 10 A.M.					
Apr 16	Coates (for family trusts)	2,000	31-31⅝		
16	Haemisegger**	300	32½		
16	Robt. L. Armstrong**	200	31¼-34½		
16	Charles Callery**	300	32½		
16	James A. Baker III**	200	32⅝		
16	Malcolm G. Baker Jr.**	500	34½-35		
16	Morgan Guaranty Trust Co.***	10,000	32⅝-34		
16	Lamont and family****	3,000	34½		

* Darke visited Mrs. Caskey and her daughter Miss Atkinson in Washington between Dec. 25 and Dec. 30, 1963 and recommended TGS. They in turn recommended TGS directly or indirectly to others marked with *, with the exception of E. W. Darke, Darke's brother, who purchased calls on Darke's recommendation.

** Purchased by Haemisegger, Coates' son-in-law, for himself and customers (**) following telephone call from Coates before 10:20 a.m.

*** Purchased for its customers' accounts following call from Lamont to Hinton at about 10:40 a.m.

**** Purchased through Morgan Guaranty Trust Co. after 12:33 p.m.

(5456) THE SECURITIES EXCHANGE ACT OF 1934 (THE ACT) AND RULE 10B-5

The Commission has instituted this action pursuant to Section 27 of the Act (15 U.S.C. 78aa) which confers upon the District Courts of the United States exclusive jurisdiction of violations of the Act or of the rules and regulations promulgated thereunder and of "all suits in equity and actions at law brought to enforce any liability or duty created by" the Act or the rules and regulations thereunder.

The preamble of the Act states that it is "to provide for the regulation or securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes."

Section 2 (15 U.S.C. 78b) provides that:

> ". . . transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, . . . and to impose requirements necessary to make such regulation and control reasonably complete and effective, (5457) in order to protect interstate commerce . . . and to insure the maintenance of fair and honest markets in such transactions. . . ."

Section 2(2) (15 U.S.C. 78b(2)) provides:

> "The prices established and offered in such transactions are generally disseminated and quoted throughout the United States and foreign countries and constitute a basis for determining and establishing the prices at which securities are bought and sold. . . ."

Section 2(3) (15 U.S.C. 18b (3)) states that:

> "Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control. . . ."

Section 4(a) (15 U.S.C. 78d(a)) provides for the establishment of the Commission as the agency charged with the administration of the Act.

Section 10 of the Act (15 U.S.C. 78j) provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> • • • • •
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

(5458) Pursuant to the authority conferred on the Commission by Section 10(b), in May, 1942 the Commission

promulgated Rule 10b-5 (17 C.F.R. 240; 10b-5), which provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

In Rule 10b-5 the Commission adapted the language of Section 17(a) of the Securities Act of 1933 (15 U.S.C. 77q) relating to fraudulent interstate transactions. Similar language was also used in Section 206 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-6).[6]

The Commission has the responsibility of administering the Act and of securing compliance therewith. To carry out this responsibility, it has been given, among other powers, authority under Sections 21(e) and 27 (15 U.S.C. 78u, 78aa) to institute actions in the district courts to (5459) enjoin existing or prospective violations of the Act and to enforce any liability or duty created by the Act or the rules and regulations promulgated pursuant thereto. The Commission contends that the defendants engaged in a "course of

business" which operated "as a fraud or deceit" on the stockholders of TGS in violation of Section 10(b) and Rule 10b-5.[7]

The defendants assert that the Commission must establish the elements of common law fraud—misrepresentation or nondisclosure, materiality, scienter, intent to deceive, reliance, and causation—citing decisions in private actions brought under Section 10(b) requiring proof of one or more of these traditional elements as a condition precedent to relief. *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783, 786 (2d Cir. 1951) ("proof of fraud is required in suits under §10(b) of the 1934 Act. . . ."); *Weber* v. *C.M.P. Corporation*, 242 F. Supp. 321, 324 (S.D.N.Y. 1965) (scienter); *Barnett* v. *Anaconda Company*, 238 F.Supp. 766, 771 (S.D.N.Y. 1965) (causation). See, Comment, "Civil Liability Under Section 10(b) and Rule 10b-5: A Suggestion for Replacing the Doctrine of Privity," 74 *Yale L. J.* 658 (1965).

(5460) However, recent decisions, even in private suits, do not require proof of these elements in actions charging violations of Rule 10b-5. *Royal Air Properties, Inc.* v. *Smith*, 312 F. 2d 210 (9th Cir. 1962); *Ellis* v. *Carter*, 291 F. 2d 270 (9th Cir. 1961). In *Stevens* v. *Vowell*, 343 F. 2d 374, 379 (10th Cir. 1965), the court stated:

> "It is not necessary to allege or prove common law fraud to make out a case under the statute and rule. It is only necessary to prove one of the prohibited actions such as the material misstatement of fact or the omission to state a material fact."

In a regulatory or enforcement proceeding under Section 27 of the Act, the Commission is not required to prove these common law elements. In *S.E.C.* v. *Capital Gains Bureau*, 375 U.S. 180 (1963), the defendant was an invest-

ment advisor who published a monthly report, mailed to approximately 5,000 customers, which recommended certain securities for long term investment. Before mailing the report, the defendant would purchase the recommended securities on the market and when the price rose after customers received the report, defendant would sell at a profit. The Commission sought an injunction under Section 206 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-6) (8) (5461) to compel defendant to disclose this practice to customers. The district court denied a preliminary injunction on the ground that "fraud" was used in the Investment Advisers Act of 1940 in its technical common law sense and that the Commission had failed to establish an intent to injure clients or an actual loss to clients. (191 F. Supp. 897, 898.) The Second Circuit Court of Appeals, sitting *en banc,* affirmed the district court by a 5-to-4 vote. (306 F. 2d 606.)

In reversing, the Supreme Court held that:

> "It would defeat the manifest purpose of the Investment Advisers Act of 1940 for us to hold, therefore, that Congress, in empowering the courts to enjoin any practice which operates 'as a fraud or deceit,' intended to require proof of intent to injure and actual injury to clients. (375 U.S., at 192.)
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> "Congress intended the Investment Advisers Act of 1940 to be *construed like other securities legislation* 'enacted for the purpose of avoiding frauds,' not technically and restrictively, but flexibly to effectuate its remedial purposes. (375 U.S., at 195.) (Emphasis supplied)

Since there is a direct parallel between the language of Rule 10b-5(3) and Section 206 of the Investment Advisers Act of 1940, both in wording and in intent, the use of "fraud" in Rule 10b-5(3) cannot be interpreted in its narrow common (5462) law sense. *Cf., Berko* v. *Securities and Exchange Commission,* 316 F. 2d 137 (2d Cir. 1963).

The suggestion made by the defendants that Section 16 of the Act (15 U.S.C. 78p), relating to directors, officers, and principal stockholders, defines "insiders" and limits the liabilities of insiders to the sanctions provided in Section 16, is equally without merit. A Section 16 action can be brought only by the corporation itself or derivatively by an existing security holder against officers, directors or beneficial owners of ten per cent or more of the corporation's listed equity securities. It covers only short-swing profits realized within a six-month period, and any recovery inures to the corporation. Profits are recoverable regardless of any intent to defraud and without proof that they were realized by reason of inside information. In short, Section 16 was enacted as a "crude rule of thumb" to make unprofitable all short-swing speculation by a specifically defined group of insiders. See, *Blau* v. *Lamb,* F. 2d (2d Cir., June 27, 1966).

A Section 10(b) action, on the other hand, may be brought pursuant to Section 27 by the Commission or by any party claiming to have been defrauded. The section (5463) applies to "any person," not merely to the persons encompassed by Section 16. *H. L. Green Co.* v. *Childree,* 185 F. Supp. 95 (S.D.N.Y. 1960) (accountants); *Cady, Roberts & Co.,* 40 S.E.C. 907 (1961) (broker). Section 16 requires both a purchase and a sale of a listed security, while Section 10(b) applies to a purchase or sale of any security. The numerous differences between Section 16 and Section

10(b) clearly indicate that the provisions of the former impose no limitation on the enforcement of the latter. See, 3 Loss, *Securities Regulation,* 1473, 1474 (2d ed. 1961); Comment, "The Prospects for Rule X-10B-5: An Emerging Remedy for Defrauded Investors," 59 *Yale L. J.* 1120, 1140-42 (1950).

To establish violations of Section 10(b) and Rule 10b-5(3), the Commission must prove that the defendants engaged in a "course of business" which operated as a "fraud or deceit . . . in connection with the purchase or sale of any security." Questions arise therefore as to whether insider purchases based on material, undisclosed information constitute violations of Section 10(b) and Rule 10b-5(3); if so, who are insiders; whether the statute and rule are limited to "face-to-face" transactions; and, finally, what constitutes material information.

(5464) The statute and rule go at least as far as the federal common law rule. *List* v. *Fashion Park, Inc.,* 340 F.2d 457, 461-2 (2d Cir. 1965). As long ago as 1909, the Supreme Court held in *Strong* v. *Rapide,* 213 U.S. 419 (1909), that the failure of the director and general manager of a corporation to disclose "special facts" in purchasing its securities operated as a fraud on the seller. The Court stated that:

> "If it were conceded, for the purpose of the argument, that the ordinary relations between directors and shareholders in a business corporation are not of such a fiduciary nature as to make it the duty of a director to disclose to a shareholder the general knowledge which he may possess regarding the value of the shares of the company before he purchases any from a shareholder, yet there are cases where, by reason of the special facts, such duty exists." 213 U.S., at 431.

Applying this "special facts" doctrine to Section 10(b) and Rule 10b-5, trading by an insider on the basis of material undisclosed information constitutes a deceptive practice in violation of the statute and rule. See, Loss, *supra*, at 1445-73.

In *Strong* v. *Rapide*, the defendant was a director and general manager of the corporation, and owned three-fourths of its outstanding shares. He was, therefore, an (5465) insider under any standard. Section 10(b) has been construed as imposing a similar liability on officers, directors, and major stockholders. *Cochran* v. *Channing Corporation*, 211 F. Supp. 239 (S.D.N.Y. 1962). Further, since Section 10(b) applies to "any person" it can include "insiders" who are not officers, directors or major stockholders. *Cady, Roberts & Co., supra*, at 912.

In *Brophy* v. *Cities Service Co.*, 70 A. 2d 5, 7 (Del. Ch. 1949), the court pointed out "if an employee in the course of his employment acquires secret information relating to his employer's business, he occupies a position of trust and confidence toward it, analogous in most respects to that of a fiduciary, and must govern his actions accordingly."

Citing *Brophy*, the Commission in *Cady, Roberts & Co., supra*, found that the obligation to disclose material information rests on two grounds:

> ". . . first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing that it is unavailable to those with whom he is dealing." 40 S.E.C., at 912.

(5466) Therefore, insiders subject to the disclosure requirements of Section 10(b) and Rule 10b-5 may include employees as well as officers, directors, and controlling stockholders who are in possession of material undisclosed information obtained in the course of their employment.

An insider's liability for failure to disclose material information which he uses to his own advantage in the purchase of securities extends to purchases made on national securities exchanges as well as to purchases in "face-to-face" transactions. *List* v. *Fashion Park, Inc., supra,* at 461-62. In *Cochran* v. *Channing Corporation, supra,* at 243, the court stated:

> "The Securities Exchange Act was enacted in part to afford protection to the ordinary purchaser or seller of securities. Fraud may be accomplished by false statements, a failure to correct a misleading impression left by statements already made or, as in the instant case, by not stating anything at all when there is a duty to come forward and speak. It is the use of inside information that gives rise to a violation of Rule 10b-5. [Citations omitted.] Lack of communication between defendant and plaintiff does not eliminate the possibility that Rule 10b-5 has been violated."

And, as noted in *Cady, Roberts,* "it would be anomalous indeed if the protection afforded by the anti-fraud provisions were withdrawn from transactions effected on exchanges, (5467) primary markets for securities transactions." 40 S.E.C., at 914.

In response to the defendants' contention that it would be impossible for an insider trading on a national exchange

to seek out the other party to the transaction and disclose material information to him (*Goodwin* v. *Agassiz*, 186 N.E. 659 (Mass. 1933)), it is clear that there are other ways of disclosing significant corporate developments. The New York Stock Exchange provides in its *Company Manual* that "important developments which might affect security values or influence investment decisions should be promptly disclosed." (Listing Agreement at A-20.) If legitimate business reasons require a period of non-disclosure, the insider should forego transactions in his company's securities during that period. *Cady, Roberts, supra,* at 911. As stated by the court in *Oliver* v. *Oliver,* 45 S.E. 232, 234 (Ga. 1903):

> "It might be that the director was in possession of information which his duty to the company required him to keep secret; and, if so, he must not disclose the fact even to the shareholder, for his obligation to the company overrides that to an individual holder of the stock. But if the fact so known to the director cannot be published, it does not follow that he may use it to his (5468) own advantage, and to the disadvantage of one whom he also represents. The very fact that he cannot disclose prevents him from dealing with one who does not know, and to whom material information cannot be made known."

However, to establish a violation of Section 10(b) and Rule 10b-5, the undisclosed information must be material. *List* v. *Fashion Park, Inc., supra.* There is nothing in the Act which precludes insiders from purchasing stock of their company or from being beneficiaries of the company's incentive stock option plan. On the contrary, it is important,

under our free enterprise system that insiders, including directors, officers, and employees, be encouraged to own securities of their company. The incentive that comes with stock ownership benefits both the company and its stockholders.

Moreover, it is obvious that any director, officer, or employee will know more about his company or have more specialized knowledge as to at least some phase of its business than an outside stockholder can have or expect to have. Often this specialized knowledge may whet the speculative interest of the insider, particularly if he believes in the future of his company, and may lead him to purchase stock. Purchases under such circumstances are not encompassed by Section 10(b) and Rule 10b-5. As stated (5469) in Loss, *supra*, at 1463:

> ". . . an insider is under no obligation to give the ordinary investor the benefit of his superior financial analysis. It has been aptly said that, 'Even though a shrewd guess by an insider is often worth fifty accounting statements, it would be highly unfair to make him publicize his guess and then to hold him responsible if it turns out to be wrong.' " (Quoting, Comment, "The Prospects for Rule X-10b-5," 59 *Yale L. J.*, at 1148.)

However, where an insider comes into possession of *material* information which he uses to his own advantage by purchasing stock or calls on the stock of his company prior to public disclosure, he violates Section 10(b) and Rule 10b-5. Information is not material merely because it would be of interest to the speculator on Bay Street or Wall Street. Material information has been defined as information "which in reasonable and objective contemplation

might affect the value of the corporation's stock or securities. . . ." *List* v. *Fashion Park, Inc., supra,* at 462, citing, *Kohler* v. *Kohler Co.,* 319 F. 2d 624, 642 (7th Cir. 1963). It is information which, if known, would clearly affect "investment judgment," *Cady, Roberts, supra,* at 911, or which directly bears on the intrinsic value of a company's stock. See, *Kardon* v. *National Gypsum Co.,* 73 F. Supp. 798 (E.D. Pa. 1947); *Speed* v. *Transamerica Corp.,* 99 F. Supp. 808 (5470) (D. Del. 1951); *Ward LaFrance Truck Corp.,* 13 S.E.C. 373 (1943).

Material information need not be limited to information which is translatable into earnings, as suggested by defendants. But the test of materiality must necessarily be a conservative one, particularly since many actions under Section 10(b) are brought on the basis of hindsight. As stated by a former member of the staff of the Commission:

> "It is appropriate that management's duty of disclosure under rule 10b-5 be limited to those situations which are essentially extraordinary in nature and which are reasonably certain to have a substantial effect on the market price of the security if disclosed. A more rigorous standard would impose an unreasonable burden on management in its securities trading. Moreover, such a standard could involve the courts to an unrealistic degree in the determination of whether certain types of information might have an impact on the market. A finer web might well prevent some management trading that represents an abuse, but only at the cost of possibly exposing management to meritless litigation in many other cases." (Fleischer, 'Securities Trading and Corporate Information Practices: The Implications of the *Texas Gulf Sulphur* Proceeding,' 51 *Va. L. Rev.* 1271, 1289 (1965).)

(5471)

APPLICATION OF SECTION 10(b) OF THE ACT AND RULE 10b-5 TO PURCHASES BY INDIVIDUAL DEFENDANTS

All of the individual defendants were directors, officers or employees of TGS. With the exceptions of Stephens and Kline, each purchased stock of TGS using the facilities of a national securities exchange. Accordingly, the jurisdictional requirements of the Act and Rule 10b-5 have been satisfied with respect to these purchases. The issue remains as to whether any of the defendants in purchasing TGS stock or calls on TGS stock were using for their own advantage material information as to the drilling on the Kidd 55 segment not disclosed to the public. Defendants Huntington and Murray had no detailed knowledge as to the work and hence were not in possession of material information. Huntington knew only that TGS was acquiring property rights in Kidd Township. Murray had no knowledge of the situation on the Kidd 55 segment at the time he made his purchases. In considering whether the remaining individual defendants were in possession of material information when they made their purchases, the period from November 12, 1963 to April 16, 1964 may be conveniently subdivided as follows:

(1) November 12, 1963 to 7:00 p.m. April 9, 1964

(2) 7:00 p.m. April 9 to 10:00 a.m. April 16, 1964

(3) April 16, 1964 from 10:00 a.m. to the close of business on that day.

(5472)

(1) *November 12, 1963 to 7:00 p.m. April 9, 1964*

K-55-1 was completed on November 12, 1963. Visual estimates at the drill site, which were subsequently confirmed

by chemical assays received in mid-December, indicated substantial zinc and copper mineralization over approximately 600 feet of the core's 657 foot length. On the basis of the visual estimates, TGS took customary security measures to maintain the secrecy of the drilling results while it undertook to acquire the remaining quarter sections of the Kidd 55 segment. On March 31, 1964 drilling was resumed.

K-55-3 was drilled and established that mineralization existed in a vertical plane over 350 feet wide and 500 feet deep. On April 7 drilling of K-55-4 was begun 200 feet south of K-55-1 and by 7:00 p.m. on April 9 it had been drilled to 421 feet and had encountered 366 feet of mineralization. K-55-1, K-55-3, and K-55-4 intersected substantial copper mineralization on the eastern edge of the anomaly.

According to the Commission's experts, Adelstein[9] (the Commission's chief mining engineer) and Pennebaker (consulting geologist to the Commission), K-55-4 established a third dimension to the mineralized zone, so that the (5473) drilling through 7:00 p.m. on April 9 established a mine.[10]

The geologists called by the defendants disputed the conclusions reached by Adelstein and Pennebaker, unanimously agreeing that the drilling of the three holes to 7:00 p.m. on April 9 did not establish that TGS had a mine. The Commission has taken the position with respect to registration statements filed under the Securities Act of 1933 that "three diamond drill holes are insufficient to determine whether a commercial ore body is present, even though they should encounter a gold bearing structure." *Pan-American Gold Ltd.*, 31 S.E.C. 141, 147-8 (1950).

It is unnecessary to determine whether TGS had a mine since the drilling of K-55-4 to 7:00 p.m. on April 9 was a strong indication that the mineralization encountered on the vertical plane between K-55-1 and K-55-3 extended southward 200 feet. There was real evidence that a body

of commercially mineable ore might exist. At 7:00 p.m. on April 9, those with knowledge of the drilling results had material information which it was reasonably certain, if disclosed, would have had a substantial impact on the market price of TGS stock. Therefore, they were under a duty not to use such material information to their personal advantage without first disclosing it to the public.

(5474) However, the drilling results up to 7:00 p.m. on April 9 did not provide such material information. When considered in relation to the far-flung business of TGS at the time, it cannot be said that the drilling results of K-55-1 and K-55-3 constituted material information, the disclosure of which would have had a substantial impact on the market price of TGS's 10,000,000 outstanding shares.

K-55-1

There is no doubt that the drill core of K-55-1 was unusually good and that it excited the interest and speculation of those who knew about it. However, all the experts agreed that one drill core does not establish an ore body, much less a mine. Defendants' experts unanimously concluded that there is no way even to estimate the probabilities that one drill core will lead to the discovery of an ore body. Concededly, the geophysical survey conducted prior to the drilling of K-55-1 indicated a "first class" anomaly over a length of more than 1,000 feet, but the conductive materials evidenced by the survey outside the first drill hole could have consisted of worthless pyrite or graphite, both of which materials were found in the core of K-55-1. As stated by Boniwell, a mining geophysicist, (5475) geophysics is of little help in predicting continuity.

Moreover, the core of K-55-1 was not solid ore. The percentages of copper and zinc mineralization fluctuated

markedly. Although it appears this is not unusual due to the complex nature of the Pre-Cambrian subsurface rock structure, it supports the testimony of defendants' experts that no predictions could be made as to how far mineral values encountered by K-55-1 extended beyond the 1⅛ inch drill core. As was brought out by Walkey, a mining engineer employed by Kamkotia Mines 12 miles from the Kidd 55 segment, mineral deposits on the Canadian Shield tend to be highly irregular in structure, with wide variations in grade. Walkey, Boniwell and Wiles (a mining engineer with forty years' experience) testified as to instances where one drill hole had produced a promising core but subsequent drilling had shown that the mineral values did not extend any appreciable distance beyond that core. Therefore, the first promising core may turn out to be a liability by inducing further drilling with negative results.[11]

Bellemore and Pearson, security analysts called by defendants, testified that from an investment point of (5476) view no significance could be attached to the results of a single drill hole, however rich.

The most that can be said of the individual defendants' knowledge after the drilling of K-55-1 is that they had "hopes, perhaps with some reason," that it would lead to a mine. *James Blackstone Mem. Lib. Ass'n* v. *Gulf, M. & O. R. Co.*, 264 F. 2d 445, 450 (7th Cir. 1959). The results of K-55-1 were too "remote" when considered in light of the size of TGS, the scope of its activities, and the number of its outstanding shares, to have had any significant impact on the market, *i.e.*, to be deemed material. *List* v. *Fashion Park, Inc., supra.*

The Commission contends, however, that the results of K-55-1 were material because of the significance attached to

those results by certain defendants. Between the completion of K-55-1 on November 12, 1963 and the completion of K-55-3 on April 7, 1964, defendants Fogarty, Mollison, Holyk, Clayton and Darke spent more than $100,000 in purchasing stock and calls on the stock of TGS. These defendants could bring considerable expertise to bear in evaluating the results of K-55-1 and their purchases may have been prompted by an educated guess that K-55-1 would (5477) lead to the discovery of a mine. Therefore, a question is presented as to whether information which may have special significance to an insider because of his professional background, is material.

A similar question would be presented where an engineer in the research department of a publicly-held corporation believes that he may have invented a process which will substantially increase the corporation's earnings or where a chemist in a large pharmaceutical firm thinks that he may have devised a chemical formula which can cure cancer. In these instances it can be assumed that the insider, because of his educated guess, will be enthusiastic and his enthusiasm may lead him to purchase stock in his company and to recommend the stock to his associates and friends even though his educated guess may turn out to be wrong. It may be argued that such purchases are "unfair" to the outside stockholders and come within the ambit of Section 10(b) and Rule 10b-5. Purchases on the basis of educated guesses may be viewed as an attempt to secure additional corporate compensation. Cary, "Corporate Standards and Legal Rules," 50 *Calif. L. Rev.* 408 (1962).

(5478) However, most insiders necessarily have educated guesses about the prospects of particular company programs. If it is held that purchases made on the basis of educated guesses are proscribed by Section 10(b) and Rule

10b-5, insiders who purchase stock in their company will do so at their peril. If they announce their educated guesses before purchasing and their guesses turn out to be wrong, they would be subject to suit; and if they purchase and keep their educated guesses to themselves and they turn out to be right, they would again be subject to suit. The creation of such a dilemma would result in insiders not buying at all although insiders should be encouraged to have a stake in the companies for which they work.

The outside stockholder can never match the knowledge of an insider who necessarily knows more about the company and is in a better position to evaluate its prospects. It may be that the "fairness" overtones of *Cady, Roberts* indicate a trend toward the elimination of all insider purchasing. But even were the Court prepared to accept the proposition that all insider trading is unfair, a proposition of doubtful validity at best, it would be deterred by the admonition of Judge Learned Hand that it is not "desirable for a lower (5479) court to embrace the exhilarating opportunity of anticipating a doctrine which may be in the womb of time, but whose birth is distant. . . ." *Spector Motor Service Inc.* v. *Walsh,* 139 F. 2d 809, 823 (2d Cir. 1944) (dissenting opinion) (reprinted in Bar Bulletin, N. Y. Co. Lawyers Assn, Vol. 23, No. 4, at 156, 1965-66). Therefore the purchases prior to 7:00 p.m. on April 9 were not based on material undisclosed information even if the purchasers had educated guesses based on the results of the first drill hole.

K-55-3

K-55-3 established that K-55-1 had not gone down dip, and indicated a vertical plane on section 2400 S containing mineralization. However there was no indication that the

mineralization extended beyond the plane. Defendant Mollison testified that at Kamkotia a drill hole could produce substantial mineralization while another 50 feet away produced a barren core. The results of K-55-3 added to the information previously known but did not constitute material information. If disclosed, it would not have had a substantial impact on the market price of the Company's stock.

Accordingly, the purchases made by certain defendants prior to 7:00 p.m. on April 9, 1964 were not based (5480) on material information. The fact that subsequent drilling established a major ore body is immaterial. As stated recently in *Value Line Fund, Inc.* v. *Marcus,* CCH FED. SEC. L. REP. ¶91,523,, at 94,956 (S.D.N.Y. 1965), "the court must be guided not by hindsight, but by the facts as they existed at the time of the . . . challenged transaction."

Similarly, purchases by Darke's "tippees" prior to 7:00 p.m. on April 9 were not made on the basis of material undisclosed information. Toward the end of December, 1963, Darke visited Caskey and Atkinson in Washington. The evidence shows no more than that Darke indicated to them that he thought TGS was a good buy. There is no direct evidence that Darke again communicated with any of his "tippees," but the record shows that on March 30, 1964 Darke and his "tippees," Atkinson, Caskey, E. W. Darke, Klotz, Miller and Westreich, purchased substantial amounts of TGS stock and calls on TGS stock. As the Commission points out, this is strong circumstantial evidence that Darke must have passed the word to one or more of his "tippees" that drilling on the Kidd 55 segment was about to be resumed. But, for the reasons hereinbefore stated, this information was not material.

(5481) For the foregoing reasons, the Court finds no violations of Section 10(b) or Rule 10b-5 on the part of any of the individual defendants who purchased shares of TGS or calls on TGS stock or recommended such purchases to others prior to 7:00 p.m. on April 9, 1964.

(2) *7:00 p.m. April 9, 1964 to 10:00 a.m. April 16, 1964*

Defendant Clayton purchased 200 shares of TGS stock on April 15; defendant Crawford purchased 600 shares on April 16. These defendants (and defendants Coates and Lamont) raise the defense that even if they were in possession of material information when they made their purchases, the material information had already become a matter of public knowledge.

The trial developed that rumors of an ore discovery by TGS were flying around Canada during the early part of April and were being given wide circulation in the Canadian press. These rumors reached the New York press by April 11, on which day they were played up in both the *New York Times* and the *New York Herald Tribune*. At this point defendants Stephens and Fogarty agreed that a press release was necessary and this decision led to the issuance of the April 12 press release hereafter discussed. Fogarty (5482) also gave instructions that a reporter from *The Northern Miner* (an important Canadian publication on the mining industry in Canada), who had previously been invited to visit the Kidd 55 segment on April 21, be asked to come on April 13 instead.

The Northern Miner reporter, Ackerley, visited the property on April 13, interviewed defendants Mollison, Holyk and Darke, looked at the records of the drilling to that time, and prepared an article for publication. The article stated in part that "The Northern Miner can say that a

major new zinc-copper-silver mine is definitely in the making, one that has all the earmarks of shaping into a substantial open pit operation . . . something in excess of 10,000,000 tons of ore is indicated." Ackerley delivered a copy of his proposed article to defendant Mollison in Timmins and it was agreed that it would not be published until cleared by Mollison. Defendants Mollison and Holyk read the article and though they felt that some of its conclusions were too optimistic, they considered it Ackerley's article and would not quibble with it. Defendant Mollison returned the article to *The Northern Miner* on the evening of April 15, and it was published in *The Northern Miner's* April 16 edition.

(5483) *The Northern Miner* had a small circulation in the United States—7,400 subscribers—including distribution in the New York area to 1,412 subscribers, who presumably received the paper on the morning of April 16. *The Northern Miner* also had a small newsstand circulation in New York, but the evidence fails to establish when the April 16 edition reached the newsstands. Reports of *The Northern Miner* article were telephoned and telexed from Toronto to some brokers in New York early on the morning of April 16 prior to the opening of the New York Stock Exchange.

The annual convention of the Canadian Institute of Mining and Metallurgy was held at the Queen Elizabeth Hotel in Montreal on April 13-15, attended by 500 to 600 representatives of the mining industry and of the business world, including some representatives from the United States. The rumors with respect to a copper discovery by TGS near Timmins were a leading subject of gossip in the corridors and bars of the hotel. The convention was attended by the Ontario Minister of Mines and his Deputy.

On the morning of April 15, defendants Mollison and Holyk met the Minister of Mines and his Deputy at the (5484) Montreal airport and flew them to Toronto, informing them during the course of the flight of the current developments on the Kidd 55 segment. The Minister indicated a desire to make a public statement and Mollison assisted him by drafting that statement. Mollison's draft concluded by saying that "the information now in hand . . . gives the company confidence to allow me (the Minister) to announce that TGS has a minable body of Zn, Cu, Ag ore of substantial dimensions that will be developed and brought to production as rapidly as possible." Mollison and Holyk were under the impression that the Minister would issue the statement in Toronto over radio and television at 11:00 p.m. on the evening of April 15 and Mollison so informed defendants Stephens and Fogarty in New York.

The Minister made no announcement on the evening of the 15th, but on the morning of the 16th, at about 9:40 a.m., he delivered the statement drafted by Mollison to the press gallery at the Ontario Parliament in Toronto. Members of the press gallery included representatives of both the Canadian and American news media, but there was no evidence as to who was in the press gallery at the time.

The effect of the foregoing was that before the market opened on April 16, some brokers and some speculators (5485) had picked up information that TGS had made an ore discovery. However, no announcement had yet been made by TGS. Only the day before, defendants Stephens, Fogarty and Crawford were preparing the announcement which was to be made at 10:00 a.m. on April 16. They took steps to assure the attendance of appropriate representatives of the news media at the press conference where the announcement would be made. The officers of TGS knew

about the rumors in Canada, the *Northern Miner* article and the pending announcement of the Ontario Minister of Mines. Had they thought that their effect was to make the material information public there would have been little purpose in making the arrangements for a press conference, and issuing a detailed announcement on April 16. The material information did not become public knowledge prior to TGS's official announcement. Therefore, insiders who purchased stock prior to TGS's announcement may not assert as a defense that the material information had already become a matter of public knowledge.

Turning now to the two defendants who purchased shares of TGS after 7:00 p.m. on April 9, 1964 and before 10:00 a.m. on April 16:

Richard H. Clayton

Clayton was a geophysicist in the employ of TGS. His job was to conduct geophysical surveys, and he conducted such surveys on the Kidd anomaly. While he did not participate (5486) in the drilling, he spent a great deal of his time at Timmins and at the Kidd 55 segment, and the evidence establishes that he kept himself fully informed. He was in Timmins on April 12 and 13 and, according to Adelstein, he told Adelstein (on June 3, 1964) that he thought TGS had a mine when he learned the results of K-55-4. While Clayton denied making this statement, he testified at a pre-trial examination that he thought that, with the results of K-55-6, TGS had a potential ore body. By 7:00 p.m. on April 13, K-55-6 had been drilled to 949 feet, encountering substantial mineralization. Indeed, no further mineralization was encountered by K-55-6 after that time. On April 14 Clayton left for New York and was in TGS's New York

office on April 15. He picked up the telephone at TGS's office in New York, called his broker in Toronto and ordered 200 shares of TGS stock. The broker executed the order on April 15 on the Midwest Stock Exchange in Chicago at 29⅜.

It is clear that at the time of this purchase Clayton was in possession of material inside information which had not yet been made available to the public and that he used this information to his own advantage. In this proceeding by the Commission it is immaterial whether (5487) Clayton intended to deceive or to defraud anyone or whether he knew at the time that his purchase would violate Section 10(b) and Rule 10b-5. The Commission has established that Clayton violated these provisions in making his April 15 purchase.

Clayton contends that he is not subject to the jurisdiction of this court. He was employed by TGS, a United States corporation, and, according to his testimony, shuttled back and forth between Canada and New York on TGS business during the period from November 1963 to April 1964. His April 15 purchase was initiated by him while he was in New York in TGS's office. He placed his order with his Toronto broker by telephone from New York to Canada, employing a channel of interstate and foreign commerce. The transaction was consummated on the Midwest Stock Exchange in Chicago. He had previously purchased TGS stock, and on two occasions his orders were executed on the New York Stock Exchange. Though he placed his orders with a Toronto broker, all his purchases were effected on an American stock exchange. Clayton's telephone call from New York on April 15 brought about the purchase. Therefore, the court has subject matter jurisdiction. (Section 27 of the Act, (5488) 15 U.S.C. 78aa; *Ferraiola* v. *Cantor,* CCH FED. SEC. L. REP. ¶91,704 (S.D.N.Y. 1966)). Under Sec-

tion 27 Clayton could be served wherever he was found and service outside of the United States has been sustained. *Ferraiola* v. *Cantor, supra; S.E.C.* v. *VTR Inc.*, CCH FED. SEC. L. REP. ¶91,618 (S.D.N.Y. 1966); *S.E.C.* v. *Briggs*, 234 F. Supp. 618 (N.D. Ohio 1964); see Advisory Committee's Note to the 1963 revision of Rule 4 of Fed. R. Civ. P. reprinted at 31 F.R.D. 627, 630 (1962). Service upon Clayton by leaving the summons and complaint with his wife at his home in Timmins was valid. (Rule 4(d)(1), (e), (f), Fed. R. Civ. P.)

DAVID M. CRAWFORD

Crawford is a lawyer who came with TGS on February 20, 1964, on which date he was appointed secretary of the Company and manager of its public and Government relations. He had not been informed as to the developments on the Kidd 55 segment. He read the rumor article in the *New York Herald Tribune* on April 11 while on his way to Houston to prepare for TGS's annual stockholders' meeting. He returned to New York either late on the 14th or early on the 15th of April, and on that day participated with Fogarty (5489) and a representative of Doremus & Co. in the preparation of the April 16 press release. The evidence establishes that by the evening of April 15 he was fully familiar with the contents of the announcement which was to be made the following morning. He spent the night in a room maintained by TGS at the Drake Hotel in New York City. About midnight he telephoned his broker in Chicago and ordered 300 shares of TGS for himself and his wife to be purchased as soon as the market opened the following day. During the night he decided to increase his order, and he telephoned his broker again at about 8:30 a.m. on April 16 to increase the order from 300 shares to 600 shares. The purchase was

executed on the Midwest Stock Exchange on April 16 at 30⅛ to 30¼.

Here again, while there is no evidence that Crawford intended to deceive or to defraud anyone, it is clear that he sought to, and did, "beat the news." There is no doubt that he believed that he could get the stock more cheaply if he bought before TGS's announcement was made. In so doing, he was utilizing material undisclosed information to his own advantage and violated Section 10(b) and Rule 10b-5. (5490)

(3) *10:00 a.m. April 16 to Close of Business on that Day*

Between the announcement and the close of business on April 16 defendants Coates and Lamont either purchased shares of TGS or recommended their purchase to others.

A regular meeting of the Board of Directors was held at TGS's offices at 9:00 a.m. on April 16. During the meeting defendant Stephens distributed copies of the announcement to be made to the press at the press conference called for 10:00 a.m. Stephens also told the Board that a statement regarding TGS's discovery had been issued in Toronto at 11:00 p.m. the previous evening by the Ontario Minister of Mines. At the conclusion of the Directors' meeting, representatives of the news media, over 22 in all, came into the Board Room. The announcement was made by Stephens, and they were given copies of the press release which Stephens, Fogarty and Crawford had prepared. The press release stated in part:

> "Texas Gulf Sulphur Company has made a major strike of zinc, copper and silver in the Timmins area of Ontario, Canada.
>
> • • • • •

"Seven drill holes are now essentially complete and indicate an ore body of at least 800 feet in length, 300 feet in width and (5491) having a vertical depth of more than 800 feet.

• • • • •

"This is a major discovery. The preliminary data indicate a reserve of more than 25 million tons of ore. The only hole assayed so far represents over 600 feet of ore, indicating a true ore thickness of nearly 400 feet.

• • • • •

"Visual examination of cores from the other holes indicate comparable grade and continuity of ore.

"The ore body is shallow, having only some 20 feet of overburden. This means that it can easily be mined initially by the open pit method."

• • • • •

Summaries of the announcement were carried over the internal news wire of Merrill Lynch, Pierce, Fenner & Smith at 10:29 a.m., and over the Dow Jones broad tape between 10:54 a.m. and 11:02 a.m.

FRANCIS G. COATES

Coates was a Houston lawyer and a member of the Board of Directors of TGS. After reading the *Herald Tribune* article of April 11 he telephoned defendant Stephens from Houston and was told by Stephens that TGS did not have (5492) enough information to know what it had. Coates

came to New York on April 15 and saw a draft of the proposed April 16 announcement that afternoon. On the 16th he attended the Directors' meeting and remained for the press conference at which the announcement was made. The press conference started at 10:00 a.m. and lasted ten or fifteen minutes. Shortly before 10:20 a.m. Coates left the meeting room and telephoned his son-in-law, Haemisegger, a broker in Houston. He told Haemisegger of TGS's discovery and ordered 2,000 shares of TGS stock for the accounts of four family trusts of which he was a trustee but not a beneficiary. Haemisegger executed the order at prices from 31 to 31⅝ on the New York and Midwest Exchanges. Haemisegger immediately imparted the information he had received from Coates to four of his customers, and they, as well as Haemisegger himself, purchased a total of 1500 shares of TGS stock at prices ranging from 31¼ to 35.

Coates lost no time in telephoning his son-in-law in order to purchase TGS stock for his family trusts. Coates could not, as could Lamont when he telephoned Hinton at the Morgan Guaranty Trust Company just before 10:40 a.m. assume "without thinking about it, that the [ore discovery] (5493) was already a matter of public information. . . ." *Cady, Roberts, supra,* at 917. The announcement had been made, however, and it has been the generally accepted rule that it is the making of the announcement that controls. For example, the Commission in *Cady Roberts* found violations of Section 10(b) and Rule 10b-5 for purchases made "during the time when respondents should have known that the board of directors . . . was taking steps to make the information publicly available but *before it was actually announced.*" *Cady, Roberts, supra,* at 915. (Emphasis supplied.) Coates, an experienced corporate lawyer, testi-

fied that he believed that the standard in the marketplace was that once the announcement is made, insiders were free to purchase stock or to recommend it to others.

It may be, as the Commission contends, that a more effective rule should be established to preclude insiders from acting on information after it has been announced but before it has been absorbed by the public. Perhaps such a rule should extend not only to corporate insiders but to others who may be in a position to take unfair advantage of the stockholders. What of a representative of the news media who, upon hearing the announcement, calls his broker before he calls (5494) his office? What of a wire house which has an inside track in getting the information to its registered representatives and to its customers? (The April 16 announcement went out over Merrill Lynch's news wire to its 145 offices half an hour before it went out over the Dow Jones ticker.) Should the representatives of the news media and the wire houses be subjected to such a rule since they are in possession of material information which the average stockholder has not had an opportunity to absorb? These examples are offered merely to illustrate the problems that arise if the present practice is to be changed.

The Commission took the position, on summation, that it is for the courts to fix a reasonable waiting period after an announcement is made, during which insiders cannot purchase stock, so that the announcement can first be absorbed by the public. In other words, it seems to be the Commission's position that a fairer practice than now exists should be evolved through court decisions. This could only lead to uncertainty. A decision in one case would not control another case with different facts. No insider would know whether he had waited long enough after an announcement had been made. He would be subject to suit by the Com-

mission (and to private (5495) suits brought by others riding on the Commission's coattails).

The Commission has not supplied, nor has the Court found, decisions specifying a waiting period after a corporate announcement is made. After this action was instituted, Cary, the former chairman of the Commission, and Fleischer, his former executive assistant, discussed a waiting period in policy terms.[12] If a waiting period is to be fixed, this could be most appropriately done by the Commission, which was established by Congress with broad rule-making powers. Should the Commission determine that it lacks authority to fix a waiting period, authority should come from Congress rather than from the courts.

Since TGS's announcement had been made when Coates telephoned Haemisegger, he did not violate Section 10(b) or Rule 10b-5.

Thomas S. Lamont

Lamont was a director of TGS. He was also a director of Morgan Guaranty Trust Company and a member of its Executive Committee and its Trust and Investment Committee. (5496) Lamont testified that he first heard of the exploration on the Kidd 55 segment on April 10 when defendant Stephens telephoned him about the rumors in Canada, and Lamont advised Stephens to ignore them unless they reached the New York press. Stephens informed Lamont that the exploration was "at the prospect stage."

Thereafter, Lamont heard rumors from friends and read the article which appeared in the *Herald Tribune* on April 11, and TGS's April 12 press release as reported in the press. On April 13 or 14 he had a conversation about the rumors with Hinton, the Executive Vice President of Mor-

gan Guaranty Trust Company. Lamont told Hinton that he knew nothing more than had appeared in the press. On April 15 Lamont was informed by Stephens that a press conference would follow the regular Directors' meeting scheduled for the morning of the 16th. Lamont attended the Directors' meeting and read the press release, and attended the press conference at which the announcement was made.

Following the announcement, and while he was still at the TGS office, Lamont telephoned Hinton about 10:40 a.m. and told Hinton that good news about TGS had come out or would be shortly coming out on "the tape." Immediately (5497) following Lamont's telephone call, Hinton telephoned his trading department and was informed that TGS stock was active and up three points. Hinton thereupon placed an order for 2,000 shares of TGS for the account of the Bank's customer, the Nassau Hospital, which order was executed at about 10:41 a.m. Thereafter, Hinton placed further orders for purchases of TGS stock for customers of the Bank, including pension trusts, purchasing a total of 10,000 shares at prices ranging from 32⅝ to 34. At about 12:30 p.m. on April 16 Lamont ordered the purchase of some 3,000 shares of TGS for himself and members of his family, which orders were executed at a price of 34½.

Lamont's telephone call to Hinton was made some 20 minutes after Coates telephoned his son-in-law, both calls being made after the announcement. His own purchases were ordered more than two hours after the announcement.

For the reasons previously stated with respect to defendant Coates, Lamont did not violate Section 10(b) or Rule 10b-5, since the announcement had been made.[13]

(5498) ***Stock Options issued by TGS to certain defendants on February 20, 1964.***

Five of the defendants—Stephens, Fogarty, Kline, Mollison and Holyk—are charged with violating Section 10(b) and Rule 10b-5 by accepting stock options voted to them on February 20, 1964 by the Directors' Committee to Administer the Restricted Stock Option Incentive Plan (the Committee).[14] The Commission contends that these defendants violated the statute and the rule because they had knowledge as to the drilling results of the first hole, K-55-1, which knowledge they failed to disclose to the Committee or to the Board of Directors prior to accepting their options.

TGS's restricted Stock Option Incentive Plan (the Plan) was inaugurated in 1961 with the approval of its stockholders.[15] Three non-management directors, John H. Hill, Leslie M. Cassidy and defendant Coates, were the members of the Committee appointed by the Board. At the meeting of the Committee held on February 20, 1964, two members, Hill and defendant Coates, were present. The minutes disclose that the Board of Directors at its meeting on March 16, 1961 had directed that no shares should be (5499) optioned to any employee earning less than $24,000 annually. The Committee granted stock options to 21 officers and employees earning $24,000 or more per annum (including defendants Stephens, Fogarty, Mollison and Kline) and recommended to the Board the granting of stock options to five employees (including defendant Holyk) whose annual salaries were in the $15,000 to $21,000 range, which recommendation was approved by the Board at its meeting later on the same day.

The use of stock option plans is a commonly accepted device to provide incentive to officers and employees. Restricted stock options of the type authorized by the stock-

holders of TGS are not uncommon in publicly-owned companies. As pointed out by Judge Weinfeld in *Kornfeld* v. *Eaton*, 217 F. Supp. 671, 677 (S.D.N.Y. 1963), *aff'd* 327 F. 2d 263 (2d Cir. 1964):

> " . . . Restricted stock options of the type here under consideration have their genesis in express approval by the stockholders of the corporation and are intended to enable its employees to benefit from an increase in the market value of the security. The corporate purpose is satisfied through the optionee's services and his efforts to further its interests. Indeed it is in the corporate economic interest that its employees have an investment stake in it. Congress itself has recognized the salutary purpose of such plans by extending them favorable tax treatment."

(5500) The Committee necessarily relied on information furnished it by the higher echelon of TGS's management (which would include defendants Stephens and Fogarty, but not Mollison, Kline or Holyk). The Committee did not inquire of the recipients what special knowledge they might have as to various phases of TGS's business as it was entitled to rely on the information furnished by the management.

The record shows that at the time they accepted their stock options, each of the five defendants (except Kline) knew of the situation on the Kidd 55 segment as it existed at the time. Since the land acquisition program had not been complete they had been instructed not to divulge this information. Indeed, on February 20, 1964, neither the Board of Directors nor the Committee had been informed.[16]

Defendant Kline was informed by defendants Stephens and Fogarty at lunch in November 1963 that TGS was co-

ducting explorations in the Timmins area and that the completion of the first drill hole was a favorable development; that it was on the boundary of the TGS property and that TGS was interested in acquiring additional property. He knew no details and his only information came from his (5501) superiors. Defendants Mollison and Holyk knew the results of K-55-1 and had reported these results to their superior, defendant Fogarty. Kline, Mollison and Holyk had no duty to inform the Committee of information already known to their superiors since they could assume that such information would be reported to the Committee by the management.

Defendants Stephens and Fogarty as President and Executive Vice President were management. Both were also Directors and potential recipients of stock options. They were under a duty to inform the Committee of material information affecting the issuance of the stock options. The Plan required that the option price be at least 95% of the fair market value of the stock on the date on which the options are to be granted. The Committee fixed the option price as "the average of the highest and lowest prices of the Company's stock on the New York Stock Exchange during February 20, 1964." Therefore, included in Stephens' and Fogarty's duty of disclosure was any material information bearing on the market value of TGS stock on that date.

A corporate officer may be guilty of fraud if he withholds material information from his company to his own advantage. *New Park Mining Co.* v. *Cranmer,* 225 F. Supp. 261 (S.D.N.Y. 1963). Therefore, if the information known (5502) to defendants Stephens and Fogarty would have substantially affected the price of the TGS stock on the New York Stock Exchange, their receipt of stock options

without disclosure to the Committee could have constituted a fraud on TGS. A stock option is a security (the Act, Section 3(a)(10); 15 U.S.C. 78c(a)(10)), so that such a fraud would have come within the ambit of Section 10(b) and Rule 10b-5. See *Ruckle* v. *Roto American Corp.*, 339 F. 2d 24 (2d Cir. 1964).

On February 20, 1964, defendants Stephens and Fogarty knew (1) that K-55-1 had been completed; (2) that the drill core had been assayed and that the assay certificates showed substantial mineralization; and (3) that the land acquisition program was in progress and that further drilling would await its completion. However, the Court has already determined that the information as to developments on the Kidd 55 segment were not material until 7:00 p.m. on April 9, some seven weeks later. The same definition of materiality applies. Since the information was not material, defendants Stephens and Fogarty were not required to disclose it to the Committee. Hence, defendants Stephens and Fogarty were not guilty of fraud or deception in failing to furnish the information. In (5503) view of the land acquisition program, the security measures which they established were for the benefit of the Company and its stockholders.[17]

In accepting the stock options granted to them on February 20, 1964, defendants Stephens, Fogarty, Kline, Mollison and Holyk did not violate Section 10(b) or Rule 10b-5.

The April 12, 1964 Press Release

On Sunday, April 12, 1964, at about 3:00 p.m., TGS issued a press release, the substance of which appeared in the Monday morning newspapers. The text of the release stated in part:

"NEW YORK, April 12—The following statement was made today by Dr. Charles F. Fogarty, executive vice president of Texas Gulf Sulphur Company, in regard to the company's drilling operations near Timmins, Ontario, Canada. Dr. Fegarty said:

" 'During the past few days, the exploration activities of Texas Gulf Sulphur in the area of Timmins, Ontario, have been widely reported in the press, coupled with rumors of a substantial copper discovery there. These reports exaggerate the scale of operations, and mention plans and statistics of size and grade of ore that are without factual basis and have evidently originated by speculation of people not connected with TGS.

" 'The facts are as follows. TGS has been exploring in the Timmins area for six (5504) years as part of its overall search in Canada and elsewhere for various minerals—lead, copper, zinc, etc. During the course of this work, in Timmins as well as in Eastern Canada, TGS has conducted exploration entirely on its own, without the participation by others. Numerous prospects have been investigated by geophysical means and a large number of selected ones have been core-drilled. These cores are sent to the United States for assay and detailed examination as a matter of routine and on advice of expert Canadian legal counsel. No inferences as to grade can be drawn from this procedure.

" 'Most of the areas drilled in Eastern Canada have revealed either barren pyrite or graphite without value; a few have resulted in discoveries of small or marginal sulphide ore bodies.

"'Recent drilling on one property near Timmins has led to preliminary indications that more drilling would be required for proper evaluation of this prospect. The drilling done to date has not been conclusive, but the statements made by many outside quarters are unreliable and include information and figures that are not available to TGS.

"'The work done to date has not been sufficient to reach definite conclusions and any statement as to size and grade of ore would be premature and possibly misleading. When we have progressed to the point where reasonable and logical conclusions can be made, TGS will issue a definite statement to its stockholders and to the public in order to clarify the Timmins project.'"

• • • • •

(5506) The Commission argues that at the time the press release was issued, TGS knew that it had discovered a copper mine on the Kidd 55 segment and that the press release was materially misleading in characterizing this discovery as a "prospect" and in stating that "any statement as to size and grade of ore would be premature." For these reasons the Commission contends that the press release violated Section 10(b) and Rule 10b-5.

TGS denies that the press release was false or misleading. Moreover, TGS contends that no violation of Section 10(b) or Rule 10b-5 is made out by the Commission since the press release was not issued "in connection with the purchase or sale of any security." However, the issuance of a false and misleading press release may constitute a violation of Section 10(b) and Rule 10b-5 if its purpose is to affect the market price of a company's stock to the advantage of the company or its insiders. *Freed* v. *Szabo*

Food Serv., Inc., CCH FED. SEC. L. REP. ¶91,317 (N.D. Ill. 1964). The phrase "in connection with the purchase or sale of any security" has been broadly construed "to carry out the intent of the Act, which is designed to protect investors against fraud." *Stockwell* v. *Reynolds & Co.*, (5507) CCH FED. SEC. L. REP. ¶91,579 at 95,198 (S.D.N.Y. 1965); *Cooper* v. *North Jersey Trust Co.*, 226 F. Supp. 972, 978 (S.D.N.Y. 1964).

During the first week of April, rumors of a copper discovery by TGS on the Kidd 55 segment were circulating in Canada. These rumors intensified, and on April 9 Toronto newspapers reported that TGS had discovered "one of the largest copper deposits in North America," "a major copper strike." On April 10, defendant Stephens telephoned defendant Lamont seeking his advice as to what action TGS should take with respect to the rumors. Lamont advised that TGS should take no action unless the rumors reached the New York press or until TGS had sufficient information available to issue an appropriate press release.

On Saturday morning, April 11, 1964, defendant Stephens, while at his home in Greenwich, Connecticut, read the articles appearing in the *New York Times* and the *New York Herald Tribune*. The *Herald Tribune* article announced that TGS had "the biggest ore strike since gold was discovered more than 60 years ago in Canada . . . a bed of copper sulphide 600 feet wide with a possible overall copper return of 2.87% through most of its width."; (5508) that TGS had four drill rigs in operation with four more to go into operation the following week; and that the richness of the copper was so great that it had been flown out of Canada to be assayed.

Stephens telephoned defendant Fogarty at the latter's home in Rye, New York and told him about the articles. Fogarty read the articles and called Stephens back. Fogar-

ty testified that he and Stephens "were quite upset . . . because certainly they [the articles] were full of exaggerations and what I considered to be erroneous statements." Stephens advised Fogarty that TGS should issue a press release to clarify the rumors, referring to his April 10 conversation with defendant Lamont. Stephens asked Fogarty to contact Carroll of Doremus & Co., the Company's public relations firm, who also lived in Rye. Fogarty did so, and Carroll agreed that TGS should issue a press release.

At about 1:00 p.m. on Saturday afternoon, April 11, Fogarty telephoned defendant Mollison at his home in Greenwich, Connecticut, and asked for a review of the situation at the Kidd 55 segment. At about 5:00 p.m. he went to Mollison's home to discuss the matter further. Mollison had been on (5509) the Kidd 55 segment on the morning of April 10 and had been advised by defendant Holyk as to the drilling results to 7:00 p.m. on April 10. At that time drill holes K-55-1, K-55-3 and K-55-4 had been completed; drilling of K-55-5 had started on Section 2200 S and had been drilled to 97 feet, encountering mineralization on the last 42 feet; and drilling of K-55-6 had been started on Section 2400 S and had been drilled to 569 feet, encountering mineralization over the last 127 feet.

In reporting the situation on the Kidd 55 segment, Mollison told Fogarty that the only known mineral occurrences in the area had been at Kamkotia and that these consisted of a series of small disconnected sulphide masses. Mollison advised that it was too early to state what TGS had and "it was impossible at that time . . . to understand the structure, to make the projections from one hole to another." Fogarty went home and drafted notes for a press release which he took to Carroll's house so that they could be put in shape by Carroll for release on Sunday, the following day. He had telephoned defendant Hunting-

ton, one of TGS's lawyers, reading his notes to him. Huntington made one or two suggestions and advised Fogarty that he thought the release would be all right legally.

(5510) On Sunday morning, April 12, Fogarty telephoned Mollison to see if he had any additional information, and instructed Mollison to return with Holyk to Timmins as soon as possible to "move things along." Fogarty and Carroll then completed the final draft of the press release at Carroll's house. Fogarty telephoned Stephens and read the final draft to him, Stephens asking certain questions and making minor changes. Stephens instructed Fogarty to have the release issued as promptly as possible so that it would be on the wires on Sunday afternoon.

From the foregoing, it is apparent that the purpose of the April 12 press release was an attempt to meet the rumors which were circulating with respect to the Kidd 55 segment. There is no evidence that TGS derived any direct benefit from the issuance of the press release or that any of the defendants who participated in its preparation used it to their personal advantage. The issuance of the release produced no unusual market action. In the absence of a showing that the purpose of the April 12 press release was to affect the market price of TGS stock to the advantage of TGS or its insiders, the issuance of the press release did not constitute a violation of Section 10(b) or (5511) Rule 10b-5 since it was not issued "in connection with the purchase or sale of any security."

However, even if it had been established that the April 12 release was issued in connection with the purchase or sale of any security, the Commission has failed to demonstrate that it was false, misleading or deceptive. The significance of the drilling results known to TGS by 7:00 p.m. on April 10 was the subject of detailed and conflicting tes-

timony at the trial. Adelstein defined proven ore and probable ore. His definitions were substantially the same as the definitions used in the General Rules and Regulations under the Securities Act of 1933, Appendix I, Form 1-A, Notification Under Regulation A, Schedule I, Item 8A(c), which provide:

> "The term 'proven ore' means a body of ore so extensively sampled that the risk of failure in continuity of the ore in such body is reduced to a minimum. The term 'probable ore' means ore as to which the risk of failure in continuity is greater than for proven ore, but as to which there is sufficient warrant for assuming continuity of the ore."

Based on these definitions and the drilling done to 7:00 p.m. on April 10, Adelstein was of the opinion that TGS could have calculated 8.33 million tons of proven ore. Pennebaker, (5512) the other Commission expert, was of the opinion that TGS could have calculated 6.2 million tons of proven ore. Both of the Commission experts stressed that the drilling showed substantial mineralization in the cores and substantial copper mineralization on the eastern edge of the anomaly. Since they could make estimates as to the size and grade of ore on the basis of information to 7:00 p.m. on April 10, the Commission contends that the use of the word "prospect" in the April 12 press release was misleading. Adelstein defined a "prospect" as a property where there is no assurance that commercially mineable reserves exist.

The opinions of Adelstein and Pennebaker were contradicted by Forrester, Park, Wiles, Walkey, Lacy and McLaughlin, independent experts called by TGS (see footnote (9)).

(5513) TGS's experts were unanimously of the opinion that at 7:00 p.m. on April 10 the Kidd 55 segment was still a prospect and that no estimates as to proven or probable ore could be made. They all agreed that the April 12 press release accurately set forth the situation as it was known at the time. None thought that TGS could have estimated proven ore, and the Commission's expert, Pennebaker, agreed that this was a matter on which there could be differences of opinion. Defendants' experts testified that on the basis of the drilling to that time there was no assurance of continuity in the mineralized zone and that, without further drilling, the results of one hole could not be correlated with the results of others.

The Commission contends none the less that the press release was misleading and deceptive because the defendants who prepared the release believed that TGS had a mine. The Commission points to the fact that drilling of K-55-8, the mill test hole, was commenced on April 11, and must have been ordered by the defendants at an earlier time. Both Adelstein and Pennebaker testified that a company does not drill a mill test hole on a "prospect."

(5514) Park, Lacy and Forrester found nothing unusual in this procedure, and Wiles testified that it was usual to begin collecting metallurgical samples as the drilling progresses. With a direct conflict in testimony between the Commission's and defendants' expert witnesses, it cannot be concluded that instructions to drill K-55-8 established that TGS knew that the Kidd 55 segment was no longer a "prospect."

The Commission also points to the *Northern Miner* article which was drafted in Timmins on April 13. Even if it is assumed that Mollison, Holyk and Darke suggested the contents of that article to Ackerley, this would not establish that the April 12 press release was false or deceptive. Using

the Commission's figures, over 30% of the relevant drilling was done between 7:00 p.m. on April 10 and 7:00 a.m. on April 13. K-55-5 was drilled an additional 507 feet; K-55-6 was drilled an additional 375 feet; drilling of K-55-7 was commenced on April 12 on Section 2000 S and was drilled to a length of 146 feet by 7:00 a.m. on April 13. The defendants are to be judged on the facts known to them when the April 12 press release was issued. Mollison and Holyk were not at the site but were in or near New York (5515) while the release was being prepared. There is no evidence that the drilling results after 7:00 p.m. on April 10 were known to the framers of the April 12 press release, so there is no more reason for charging TGS with this knowledge than with knowledge of the statement drafted by Mollison for the Ontario Minister of Mines on April 15, or with knowledge of the information that was available to TGS when it made its announcement on April 16.

Moreover, the circumstances under which the April 12 release was prepared indicate that defendants Fogarty and Mollison were under considerable pressure. If they said too much, they would have been open to criticism and possible liability if it turned out that TGS had not discovered a commercial mine. If they said too little and later announced a mine, they subjected themselves to the charge that their press release was misleading or deceptive—and, indeed, this is what has happened. If they had announced the drilling results in terms of number of drill holes, footage drilled and mineralization intersected, they would have encouraged the rumor mill which they were seeking to allay. Perhaps they should have waited until they could have obtained more probative information before issuing a press release, particularly (5516) since developments were breaking so rapidly. However, as above stated, TGS must not be judged by hindsight. In seeking the advice of Mollison, the

ad of TGS's exploration group, in consulting with TGS's blic relations firm, and in clearing the release with one f TGS's lawyers, Stephens and Fogarty exercised reasonable business judgment under the circumstances. While, in retrospect, the press release may appear gloomy or incomplete, this does not make it misleading or deceptive on the basis of the facts then known.[18]

Accordingly, in issuing the April 12 press release TGS did not violate Section 10(b) or Rule 10b-5.

Conclusion

The foregoing constitutes the Court's findings of fact and conclusions of law (Rule 52(a), Fed. R. Civ. P.).

There appearing no just reason for delay, the Clerk is directed to enter judgment dismissing the complaint against defendants Texas Gulf Sulphur Company, Charles F. Fogarty, Richard D. Mollison, Walter Holyk, Kenneth H. Darke, Thomas S. Lamont, Francis G. Coates, Claude O. Stephens, John A. Murray, Earl L. Huntington and Harold B. Kline (Rule 58(1), Fed. R. Civ. P.).

(5517) Defendants Richard H. Clayton and David M. Crawford are found to have violated Section 10(b) of the Act and Rule 10b-5. In accordance with the agreement between the parties, the Commission may notice a hearing to determine the remedy to be accorded with respect to these two defendants.

It is so ordered.

Dated: New York, N. Y.
August 16, 1966.

Dudley B. Bonsal
U. S. D. J.

Filed August 19, 1966

(5518) Footnotes to Opinion in Securities and Exchange Commission v. Texas Gulf Sulphur Company, et al. 65 Civ. 1182

(1) At least 49 private actions are now pending in this court against TGS, defendants named in the Commission's action, and others, arising out of the transactions which are the subject matter of the Commission's action. Some 16 of these are individual actions, 31 are said to be class actions, and one is a derivative action. At least 475 persons are included as plaintiffs. While many of the complaints do not specify the damages claimed, others, in the aggregate, claim compensatory damages in excess of $2,800,000 and punitive damages in excess of $77,000,000.

(2) Certain minerals combine with sulphur to form sulphides. Some sulphides, such as chalcopyrite (copper sulphide) and sphalerite (zinc sulphide), may be commercially mined if found in sufficient quantities; others, such as pyrite and pyrrhotite (iron sulphides), have no commercial value.

(3) The electromagnetic instruments used in the aerial geophysicial surveys indicate only that a conductor of electricity exists. There are many good conductors besides sulphides. For example, graphite and even water are good conductors. On the other hand, zinc sulphides are not conductors.

(4) Prior to April 7 a shortage of water needed for drilling prevented the operation of more than one drill rig. The second rig was put into operation on April 8, and the third and fourth rigs were put into operation on April 10 and 12 respectively.

(5) Seven feet of snow on the ground during this period impeded travel between the Kidd 55 segment and Timmins, 15 miles away, the trip taking as long as four hours.

(6) Rule 10b-5 is general in terms. Other rules under Section 10(b) are more specific. See Rule 10b-6, which applies Section 10(b) to underwriters, issuers, brokers, dealers, etc. Compare also Rule 10b-2 with reference to solicitation of purchases on an exchange to facilitate a distribution of securities.

(5519) (7) In its briefs and at trial the Commission made no distinction between the three sections of Rule 10b-5, rely-

ing on *List* v. *Fashion Park, Inc.*, 340 F. 2d 457, 462 (2d Cir. 1965), where the court noted that as long as a violation of the Rule is alleged, it makes little difference which section of the Rule is invoked. There was no evidence, however, that the defendants employed "any device, scheme, or artifice to defraud" under section (1) or made any representations under section (2). Therefore, only section (3) is applicable to the facts of this case.

(8) Section 206 provides in part that:

> "It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;
>
> (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client; . . ."

(9) At the trial, the Commission called as expert witnesses Benjamin Adelstein and Edwin M. Pennebaker. Mr. Adelstein has been the Chief Mining Engineer for the Commission since 1941. He was previously employed by Anaconda Copper Company and by the United States Coast and Geodetic Survey and the United States Corps of Engineers. Mr. Pennebaker is a mining geologist from Scottsdale, Arizona with many years of experience, who was appointed Consulting Geologist to the Commission in November 1965.

TGS called as expert witnesses: James D. Forrester, geologist, Dean of the University of Arizona School of Mines and Director of the Arizona Bureau of Mines, Tucson, Arizona; Charles F. Park, Jr., geologist, Professor of Geology at Stanford University, where he was Dean of the School of Earth Sciences from 1950-1965; Cloyd M. Wiles, mining engineer with National Lead Company from 1942 until his retirement in 1963; Graham Walkey, mining engineer and geologist with Kamkotia Mines, which is located approximately 12 miles from the Kidd 55 segment; Willard C. Lacy, geologist, professor at the University of Arizona and head of the University's Department of Mining and Engineering; Donald McLaughlin, geologist, Chairman of the Board and formerly president of Homestake Mining

Company; John B. Boniwell, geophysicist with eight years' experience on the Canadian Shield; Douglas H. Bellemore, security analyst, Professor of Finance at the Graduate School of Business (5520) Administration at New York University; and Alvin W. Pearson, security analyst, president of Lehman Corporation and chairman of its Portfolio Committee.

(10) Adelstein testified that on the basis of work done to 7:00 p.m. on April 9 TGS could have calculated ore reserves of 7.7 million tons with a gross assay value of $204,200,000. Pennebaker testified that TGS could have calculated ore reserves of 5.5 million tons with a gross assay value of $197,200,000. Adelstein defined gross assay value to mean "the sum of the products of the number of units of each metal of commercial value times the prevailing price for each metal . . ." Since gross assay value does not take account of the costs of mining, milling, smelting, sales, overhead, cost of capital, etc., it can be misleading and its use in registration statements is prohibited by the Commission. For example, Wiles estimated that 95.2% of the gross assay value of the ore deposit on the Kidd 55 segment would be expended for the above purposes. Although his figures appear to be conservative and though ore with a much lower gross assay value than that on the Kidd 55 segment is commercially mined, his testimony illustrates why gross assay value is not a good indicator.

(11) Members of the TGS exploration group could not state with certainty that K-55-1 had not been drilled down dip. In a memorandum written on November 14, 1963, defendant Holyk stated that:

> "While there are some indications that the drill hole is drilling across the dip, there are also numerous instances of bedding and minerals stratification to be almost parallel to the core axis. Accordingly, it is impossible to estimate the true width of the sulphide zone until a second drill hole is directed across this intersection from west to east. It may well be that the zone is quite narrow in the event that the drill hole has been directed down dip."

The Commission offered testimony as to banding, mineral stratification within the drill core, to establish that K-55-1 had been drilled across the mineral zone and not down dip. The significance of banding, particularly without more drilling, was strongly disputed by defendants' experts.

(5520) (12) In a symposium held on November 22, 1965, former Commission Chairman Cary stated:

> "Directly related is the question when insiders can trade. Again, I doubt whether we can supply a definitive answer. In general, the answer may be: not prior to the time the news has been absorbed by the market. The President of the New York Stock Exchange has suggested thirty days, beginning one week after the distribution of a comprehensive annual report . . . This line, I think, is strict; it goes beyond law, and is really a policy doctrine that he has enunciated. It goes beyond what a lawyer might advise." (Symposium, "Insider Trading in Stocks, *The Business Lawyer,* Vol. XXI, 1009, 1014-1015 (1966).)

Fleischer has written:

> "As a general principle, an insider might be held to violate rule 10b-5 whenever he trades before the effect of the news in question has been absorbed by the market.
>
> • • • • •
>
> "As a matter of corporate practice, it would be advisable for any insider to forego any trading for, say, an arbitrary twenty-four hour period after important news is released to the public." (Fleischer, "Securities Trading and Corporate Information Practices: The Implications of the *Texas Gulf Sulphur Proceeding,*" 51 *Va. L. Rev.* 1271, 1291 (1965).)

(13) Since no violations of Section 10(b) or Rule 10b-5 have been found as to those defendants who recommended TGS stock to others, it is not necessary to consider whether an insider who violates the Statute or the Rule may be liable for purchases made by his "tippees."

(14) The stock options accepted by these defendants were as follows:

Stephens	for	12,800	shares
Fogarty	"	7,300	"
Kline	"	4,300	"
Mollison	"	4,300	"
Holyk	"	2,000	"

Stock options were granted to 21 other officers and employees at the same time, and the total number of shares covered by stock options granted on February 20, 1964 was 89,950.

(5521) (15) The Plan provided that the options would run for ten years from the date of issue, subject to automatic termination in the event of the death or termination of employment of the recipient. At its meeting, the Committee recommended that the plan be amended to reduce the option period from ten years to five years, to become effective on passage of pending Congressional legislation to that effect; that such amendment apply to the options granted on February 20, 1964; and further, that the options issued on February 20, 1964 could not be exercised while any previous qualified or restricted option was held by the optionee. The options provided that the optionees could exercise up to 40% at any time after 18 months, 70% at any time after three years and 100% at any time after four years.

(16) The Board was not informed until its meeting on April 16, 1964, when the Directors were given copies of the press release which was issued following the meeting.

(17) After the Commission instituted this action, the Board of Directors, on July 15, 1965, ratified the issuance of the stock options to Kline, Mollison and Holyk. Stephens and Fogarty surrendered to TGS the options which they received, and these options have been cancelled.

(18) That the drilling results to 7:00 p.m. on April 9 have been held to be material information does not lead to the conclusion that the Kidd 55 segment was either a mine or a prospect twenty-four hours later. It means only that insiders could act on this material information to their own advantage prior to its disclosure to the public.

Appendix A — Judgment of the District Court (Entered August 22, 1966)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

[SAME TITLE]

The defendant Thomas P. O'Neill having been served with a summons and complaint, and said defendant having failed to answer or appear herein, and the plaintiff having moved for a default judgment in a separate proceeding, and all the remaining parties having waived a jury and having agreed that trial should first be had on the issue of whether defendants or any of them had violated Section 10(b) and Rule 10b-5 reserving for a later hearing the issue of the remedy to be applied in the event such violations are found, and the said issue having been brought on regularly for trial before the Honorable Dudley B. Bonsal, United States District Judge, on May 9, 10, 11, 12, 13, 23, 24, 25, 26, 27, 31 and June 1, 2, 3, 6, 7, 8 and 21, 1966, and the Court having reserved decision at the conclusion of the evidence, and the Court thereafter having handed down its opinion decision, dated August 16, 1966 and filed on August 19, 1966 constituting the Court's findings of fact and conclusions of law dismissing the complaint as to all defendants except Richard H. Clayton and David M. Crawford, and the Court having found that the defendants Richard H. Clayton and David M. Crawford had violated Section 10(b) of the Act and Rule 10b-5, and the Court in its opinion decision having stated that there was no just reason for delay of entry of this Judgment, it is

Appendix A — Judgment of the District Court

ORDERED, ADJUDGED AND DECREED: That the defendants, Texas Gulf Sulphur Company, a Texas corporation, Charles F. Fogarty, Richard D. Mollison, Walter Holyk, Kenneth H. Darke, Thomas S. Lamont, Francis G. Coates, Claude O. Stephens, John A. Murray, Earl L. Huntington and Harold B. Kline have judgment against the plaintiff Securities and Exchange Commission dismissing the complaint, and it is further,

ORDERED, ADJUDGED AND DECREED: That the defendants Richard H. Clayton and David M. Crawford have violated Section 10(b) of the Act and Rule 10b-5, and pursuant to agreement between the parties, the Securities and Exchange Commission may notice a hearing to determine the remedy to be accorded with respect to these two defendants.

Dated: New York, N.Y.
August 22, 1966

John J. Olear, Jr.
Clerk

Appendix A — Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 296—September Term, 1966.

(Argued March 20, 1967
Submitted to the *in banc* Court May 2, 1968
Decided August 13, 1968.)

Docket No. 30882

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellant,

—v.—

TEXAS GULF SULPHUR CO., a Texas Corporation, CHARLES F. FOGARTY, RICHARD D. MOLLISON, WALTER HOLYK, KENNETH H. DARKE, FRANCIS G. COATES, CLAUDE O. STEPHENS, JOHN A. MURRAY, EARL L. HUNTINGTON, and HAROLD B. KLINE,

Defendants-Appellees.

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

—v.—

DAVID M. CRAWFORD and RICHARD H. CLAYTON,

Defendants-Appellants.

Before:

LUMBARD, *Chief Judge*,
WATERMAN, MOORE, FRIENDLY, SMITH, KAUFMAN, HAYS,
ANDERSON and FEINBERG, *Circuit Judges*.

In the United States District Court for the Southern District of New York the Securities and Exchange Commission commenced its action pursuant to 15 U. S. C. §§78u, 78aa, against Texas Gulf Sulphur Company and thirteen individuals alleging violations by the fourteen defendants of the provisions of Section 10b of the Securities Exchange Act of 1934, 15 U. S. C. §78j(b), and its Rule 10b-5 (17 C. F. R. 240.10b-5) promulgated pursuant to the authority granted to it in Section 10b.

The court below, Bonsal, *J.*, found that two of the individual defendants, Clayton and Crawford, had violated Section 10b and Rule 10b-5, but otherwise the Commission's complaint was ordered dismissed, 258 F. Supp. 262 (1966).

Appeals were taken by the Commission and by Clayton and Crawford. Eleven of the thirteen original individual defendants, and the corporation, are parties in the proceedings before us.

The appeals were argued before a division of the court consisting of Judges Waterman, Moore, and Hays. When the opinions prepared by them were distributed to the other judges of the court it was ordered on May 2, 1968 that the case should, without further argument, be considered *in banc* upon the record and briefs the parties had filed and upon the opinions that had been prepared and distributed by the panel judges. After *in banc* consideration the opinions appearing hereafter were prepared. The results reached in Judge Waterman's opinion for the court are

concurred in unanimously as to appellee Coates, and appellants Clayton and Crawford; as to the remaining contested issues that opinion represents results concurred in either generally or in separate statements by a majority of the judges.

The dispositions below as to appellants Clayton and Crawford are affirmed. As to one of the appellees, Murray, the disposition below is affirmed. As to the remaining individual appellees and the corporation, the order dismissing the complaint is reversed and the cause remanded for further proceedings below consistent with the opinion of the court.

PHILIP A. LOOMIS, JR., Gen. Counsel; DAVID FERBER, Solicitor; ROGER S. FOSTER, Spec. Counsel, Ofc. of Policy Research, SEC; FRANK E. KENNAMER, JR., Asst. Gen. Counsel; DONALD M. FEUERSTEIN, Atty., SEC, *for Securities and Exchange Commission.*

ORISON S. MARDEN, White & Case, WILLIAM D. CONWELL, EDWARD C. SCHMULTS, P. R. KONRAD KNAKE, THOMAS MCGANNEY, PETER G. EIKENBERRY, New York City, *for Texas Gulf Sulphur, Fogarty, Mollison, Holyk, Darke, Stephens, Murray, Huntington and Kline, Crawford and Clayton.*

ALBERT R. CONNELLY, DONALD I. STRAUBER, Cravath, Swaine & Moore, New York City, *for Coates.*

WATERMAN, *Circuit Judge*:

This action was commenced in the United States District Court for the Southern District of New York by the

Securities and Exchange Commission (the SEC) pursuant to Sec. 21(e) of the Securities Exchange Act of 1934 (the Act), 15 U. S. C. §78u(e), against Texas Gulf Sulphur Company (TGS) and several of its officers, directors and employees, to enjoin certain conduct by TGS and the individual defendants said to violate Section 10(b) of the Act, 15 U. S. C. Section 78j(b), and Rule 10b-5 (17 CFR 240.10b-5) (the Rule), promulgated thereunder, and to compel the rescission by the individual defendants of securities transactions assertedly conducted contrary to law.[1] The complaint alleged (1) that defendants Fogarty, Mollison, Darke, Murray, Huntington, O'Neill, Clayton, Crawford, and Coates had either personally or through agents purchased TGS stock or calls thereon from November 12, 1963 through April 16, 1964 on the basis of material inside information concerning the results of TGS drilling in Timmins, Ontario, while such information remained undisclosed to the investing public generally or to the particular sellers[2]; (2) that defendants Darke and Coates had di-

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1 Pursuant to a stipulation by all parties, the question of the appropriate remedies to be applied was deferred pending a final determination whether the defendants or any of them had violated Section 10(b) and Rule 10b-5 and therefore that question is not now before us.

2 The purchases by the parties during this period were:

Purchase		*Shares*		*Calls*	
Date	*Purchaser*	*Number*	*Price*	*Number*	*Price*
Hole K-55-1 Completed November 12, 1963					
1963					
Nov. 12	Fogarty	300	17¾-18		
15	Clayton	200	17¾		
15	Fogarty	700	17⅝-17⅞		
15	Mollison	100	17⅞		
19	Fogarty	500	18⅛		
26	Fogarty	200	17¾		
29	Holyk (Mrs.)	50	18		

Chemical Assays of Drill Core of K-55-1 Received December 9-13, 1963

(*footnote continued on next page*)

vulged such information to others for use in purchasing TGS stock or calls[3] or recommended its purchase while the

Purchase			*Shares*		*Calls*	
Date		*Purchaser*	*Number*	*Price*	*Number*	*Price*
1963						
Dec.	10	Holyk (Mrs.)	100	20⅜		
	12	Holyk (or wife)			200	21
	13	Mollison	100	21⅛		
	30	Fogarty	200	22		
	31	Fogarty	100	23¼		
1964						
Jan.	6	Holyk (or wife)			100	23⅝
	8	Murray			400	23¼
	24	Holyk (or wife)			200	22¼-22⅜
Feb.	10	Fogarty	300	22⅛-22¼		
	20	Darke	300	24⅛		
	24	Clayton	400	23⅞		
	24	Holyk (or wife)			200	24⅛
	26	Holyk (or wife)			200	23⅜
	26	Huntington	50	23¼		
	27	Darke (Moran as nominee)			1000	22⅝-22¾
Mar.	2	Holyk (Mrs.)	200	22⅜		
	3	Clayton	100	22¼		
	16	Huntington			100	22⅜
	16	Holyk (or wife)			300	23¼
	17	Holyk (Mrs.)	100	23⅞		
	23	Darke			1000	24¾
	26	Clayton	200	25		
Land Acquisition Completed March 27, 1964						
Mar.	30	Darke			1000	25½
	30	Holyk (Mrs.)	100	25⅞		
Core Drilling of Kidd Segment Resumed March 31, 1964						
April	1	Clayton	60	26½		
	1	Fogarty	400	26½		
	2	Clayton	100	26⅞		
	6	Fogarty	400	28⅛-28⅞		
	8	Mollison (Mrs.)	100	28⅛		
First Press Release Issued April 12, 1964						
April	15	Clayton	200	29⅜		
	16	Crawford (and wife)	600	30⅛-30¼		
Second Press Release Issued 10:00-10:10 or 10:15 A.M., April 16, 1964						
April	16	(app. 10:20 A.M.) Coates (for family trusts)	2000	31 -31⅝		

3 A "call" is a negotiable option contract by which the bearer has the right to buy from the writer of the contract a certain number of shares of a particular stock at a fixed price on or before a certain agreed-upon date.

information was undisclosed to the public or to the sellers;[4] that defendants Stephens, Fogarty, Mollison, Holyk, and

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4 The purchases made by "tippees" during this period were:

Purchase Date	Purchaser	Shares Number	Shares Price	Calls Number	Calls Price
Chemicals Assays of K-55-1 Received Dec. 9-13, 1963					
1963					
Dec. 30	Caskey (Darke)			300	22¼
1964					
Jan. 16	Westreich (Darke)	2000	21¼-21¾		
Feb. 17	Atkinson (Darke)	50	23¼	200	23⅛
17	Westreich (Darke)	50	23¼	1000	23¼-23⅜
24	Miller (Darke)			200	23¾
25	Miller (Darke)			300	23⅜-23½
Mar. 3	E. W. Darke (Darke)			500	22½-22⅝
17	E. W. Darke (Darke)			200	23⅜
Land Acquisition Completed Mar. 27, 1964					
1964					
Mar. 30	Atkinson (Darke)				
	Caskey (Darke)	100	25⅞	400	25¾-25⅞
	E. W. Darke (Darke)				
	Miller (Darke)			1000	25¾-25⅞
	Westreich (Darke)	500	25¾	200	25½
30-31	Klotz (Darke)			2000	25½-26⅛

Second Press Release Issued April 16, 1964 (Reported over Dow Jones tape at 10:54 A.M.)

April 16 (from 10:31 A.M.)

Haemisegger (Coates) 1500 31¼-35

In this connection, we point out that, though several of the Holyk purchases of shares and calls made between November 29, 1963 and March 30, 1964 were in the name of Mrs. Holyk or were in the names of both spouses, we have treated these purchases as if made in the name of defendant Holyk alone.

Defendant Mollison purchased 100 shares on November 15 in his name only and on April 8 100 shares were purchased in the name of Mrs. Mollison. We have made no distinction between those purchases.

Defendant Crawford ordered 300 shares about midnight on April 15 and 300 more shares the following morning, to be purchased for himself, and his wife, and these purchases are treated as having been made by the defendant Crawford.

In these particulars we have followed the lead of the court below. See the table at 258 F. Supp. 273-275 and the special references to the Holyk purchases at 273, and the Crawford purchases at 287. It would be unrealistic to include any of these purchases as having been made by other than the defendants, and unrealistic to include them as having been made by members of the general public receiving "tips" from insiders.

Kline had accepted options to purchase TGS stock on Feb. 20, 1964 without disclosing the material information as to the drilling progress to either the Stock Option Committee or the TGS Board of Directors; and (4) that TGS issued a deceptive press release on April 12, 1964. The case was tried at length before Judge Bonsal of the Southern District of New York, sitting without a jury. Judge Bonsal in a detailed opinion[5] decided, *inter alia*, that the insider activity prior to April 9, 1964 was not illegal because the drilling results were not "material" until then; that Clayton and Crawford had traded in violation of law because they traded after that date; that Coates had committed no violation as he did not trade before disclosure was made; and that the issuance of the press release was not unlawful because it was not issued for the purpose of benefiting the corporation, there was no evidence that any insider used the release to his personal advantage and it was not "misleading, or deceptive on the basis of the facts then known," 258 F. Supp. 262, at 292-296 (SDNY 1966). Defendants Clayton and Crawford appeal from that part of the decision below which held that they had violated Sec. 10(b) and Rule 10b-5 and the SEC appeals from the remainder of the decision which dismissed the complaint against defendants TGS, Fogarty, Mollison, Holyk, Darke, Stephens, Kline, Murray, and Coates.[6]

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5 258 F. Supp. 262 (SDNY 1966).

6 Defendant O'Neill did not appear to answer the charge against him; the SEC motion to enter a default judgment against him was denied without prejudice to its renewal upon completion of this appeal.

Shortly after the appeal was argued defendant Lamont passed away, and by agreement of the parties an order was entered discontinuing his appeal and directing that the judgment below dismissing the action against him be severed from the judgment as to the other defendants.

The SEC does not contest the alternative holding below that Holyk and Mollison, not being members of TGS's top management, had no duty of disclosure prior to acceptance of stock options.

For reasons which appear below, we decide the various issues presented as follows:

(1) As to Clayton and Crawford, as purchasers of stock on April 15 and 16, 1964, we affirm the finding that they violated 15 U. S. C. §78j(b) and Rule 10b-5 and remand, pursuant to the agreement by all the parties, for a determination of the appropriate remedy.

(2) As to Murray, we affirm the dismissal of the complaint.

(3) As to Mollison and Holyk, as recipients of certain stock options, we affirm the dismissal of the complaint.

(4) As to Stephens and Fogarty, as recipients of stock options, we reverse the dismissal of the complaint and remand for a further determination as to whether an injunction, in the exercise of the trial court's discretion, should issue.

(5) As to Kline, as a recipient of a stock option, we reverse the dismissal of the complaint and remand with directions to issue an order rescinding the option and for a determination of any other appropriate remedy in connection therewith.

(6) As to Fogarty, Mollison, Holyk, Darke, and Huntington, as purchasers of stock or calls thereon between November 12, 1963, and April 9, 1964, we reverse the dismissal of the complaint and find that they violated 15 U. S. C. §78j(b) and Rule 10b-5, and remand, pursuant to the agreement of all the parties, for a determination of the appropriate remedy.

(7) As to Clayton, although the district judge did not specify that the complaint be dismissed with respect to

his purchases of TGS stock before April 9, 1964, such a dismissal is implicit in his treatment of the individual appellees who acted similarly. Consequently, although Clayton is named only as an appellant our decision with respect to the materiality of K-55-1 renders it necessary to treat him also as an appellee. Thus, as to him, as one who purchased stock between November 12, 1963 and April 9, 1964, we reverse the implicit dismissal of the complaint, find that he violated §78j(b) and Rule 10b-5, and remand, pursuant to the agreement by all the parties, for a determination of the appropriate remedy.

(8) As to Drake, as one who passed on information to tippees, we reverse the dismissal of the complaint and remand, pursuant to the agreement by all the parties, for a determination of the appropriate remedy.

(9) As to Coates, as one who on April 16th purchased stock and gave information on which his son-in-law broker and the broker's customers purchased shares, we reverse the dismissal of the complaint, find that he violated 15 U. S. C. §78j(b) and Rule 10b-5, and remand, pursuant to the agreement by all the parties, for a determination of the appropriate remedy.

(10) As to Texas Gulf Sulphur, we reverse the dismissal of the complaint and remand for a further determination by the district judge in the light of the approach taken in this opinion.

The occurrences out of which this litigation arose are not set forth hereafter in as detailed a manner as they are set out in the published opinion of the court below, but are stated sufficiently, we believe, for the exposition of the issues raised by the several appeals to us.

The Factual Setting

This action derives from the exploratory activities of TGS begun in 1957 on the Canadian Shield in eastern Canada. In March of 1959, aerial geophysical surveys were conducted over more than 15,000 square miles of this area by a group led by defendant Mollison, a mining engineer and a Vice President of TGS. The group included defendant Holyk, TGS's chief geologist, defendant Clayton, an electrical engineer and geophysicist, and defendant Darke, a geologist. These operations resulted in the detection of numerous anomalies, i.e., extraordinary variations in the conductivity of rocks, one of which was on the Kidd 55 segment of land located near Timmins, Ontario.

On October 29 and 30, 1963, Clayton conducted a ground geophysical survey on the northeast portion of the Kidd 55 segment which confirmed the presence of an anomaly and indicated the necessity of diamond core drilling for further evaluation. Drilling of the initial hole, K-55-1, at the strongest part of the anomaly was commenced on November 8 and terminated on November 12 at a depth of 655 feet. Visual estimates by Holyk of the core of K-55-1 indicated an average copper content of 1.15% and an average zinc content of 8.64% over a length of 599 feet. This visual estimate convinced TGS that it was desirable to acquire the remainder of the Kidd 55 segment, and in order to facilitate this acquisition TGS President Stephens instructed the exploration group to keep the results of K-55-1 confidential and undisclosed even as to other officers, directors, and employees of TGS. The hole was concealed and a barren core was intentionally drilled off the anomaly. Meanwhile, the core of K-55-1 had been shipped to Utah for chemical assay which, when received in early December, revealed an average mineral content of 1.18% copper, 8.26%

zinc, and 3.94% ounces of silver per ton over a length of 602 feet. These results were so remarkable that neither Clayton, an experienced geophysicist, nor four other TGS expert witnesses, had ever seen or heard of a comparable initial exploratory drill hole in a base metal deposit. So, the trial court concluded, "There is no doubt that the drill core of K-55-1 was unusually good and that it excited the interest and speculation of those who knew about it." *Id.* at 282. By March 27, 1964, TGS decided that the land acquisition program had advanced to such a point that the company might well resume drilling, and drilling was resumed on March 31.

During this period, from November 12, 1963 when K-55-1 was completed, to March 31, 1964 when drilling was resumed, certain of the individual defendants listed in fn. 2, *supra,* and persons listed in fn. 4, *supra,* said to have received "tips" from them, purchased TGS stock or calls thereon. Prior to these transactions these persons had owned 1135 shares of TGS stock and possessed no calls; thereafter they owned a total of 8235 shares and possessed 12,300 calls.

On February 20, 1964, also during this period, TGS issued stock options to 26 of its officers and employees whose salaries exceeded a specified amount, five of whom were the individual defendants Stephens, Fogarty, Mollison, Holyk, and Kline. Of these, only Kline was unaware of the detailed results of K-55-1, but he, too, knew that a hole containing favorable bodies of copper and zinc ore had been drilled in Timmins. At this time, neither the TGS Stock Option Committee nor its Board of Directors had been informed of the results of K-55-1, presumably because of the pending land acquisition program which required confidentiality. All of the foregoing defendants accepted the options granted them.

When drilling was resumed on March 31, hole K-55-3 was commenced 510 feet west of K-55-1 and was drilled easterly at a 45° angle so as to cross K-55-1 in a vertical plane. Daily progress reports of the drilling of this hole K-55-3 and of all subsequently drilled holes were sent to defendants Stephens and Fogarty (President and Executive Vice President of TGS) by Holyk and Mollison. Visual estimates of K-55-3 revealed an average mineral content of 1.12% copper and 7.93% zinc over 641 of the hole's 876-foot length. On April 7, drilling of a third hole, K-55-4, 200 feet south of and parallel to K-55-1 and westerly at a 45° angle, was commenced and mineralization was encountered over 366 of its 579-foot length. Visual estimates indicated an average content of 1.14% copper and 8.24% zinc. Like K-55-1, both K-55-3 and K-55-4 established substantial copper mineralization on the eastern edge of the anomaly. On the basis of these findings relative to the foregoing drilling results, the trial court concluded that the vertical plane created by the intersection of K-55-1 and K-55-3, which measured at least 350 feet wide by 500 feet deep extended southward 200 feet to its intersection with K-55-4, and that "There was real evidence that a body of commercially mineable ore might exist." *Id.* at 281-82.

On April 8 TGS began with a second drill rig to drill another hole, K-55-6, 300 feet easterly of K-55-1. This hole was drilled westerly at an angle of 60° and was intended to explore mineralization beneath K-55-1. While no visual estimates of its core were immediately available, it was readily apparent by the evening of April 10 that substantial copper mineralization had been encountered over the last 127 feet of the hole's 569-foot length. On April 10, a third drill rig commenced drilling yet another hole, K-55-5, 200 feet north of K-55-1, parallel to the prior

holes, and slanted westerly at a 45° angle. By the evening of April 10 in this hole, too, substantial copper mineralization had been encountered over the last 42 feet of its 97-foot length.

Meanwhile, rumors that a major ore strike was in the making had been circulating throughout Canada. On the morning of Saturday, April 11, Stephens at his home in Greenwich, Conn. read in the New York Herald Tribune and in the New York Times unauthorized reports of the TGS drilling which seemed to infer a rich strike from the fact that the drill cores had been flown to the United States for chemical assay. Stephens immediately contacted Fogarty at his home in Rye, N. Y., who in turn telephoned and later that day visited Mollison at Mollison's home in Greenwich to obtain a current report and evaluation of the drilling progress.[7] The following morning, Sunday, Fogarty again telephoned Mollison, inquiring whether Mollison had any further information and told him to return to Timmins with Holyk, the TGS Chief Geologist, as soon as possible "to move things along." With the aid of one Carroll, a public relations consultant, Fogarty drafted a press release designed to quell the rumors, which release, after having been channeled through Stephens and Huntington, a TGS attorney, was issued at 3:00 P.M. on Sunday, April 12, and which appeared in the morning newspapers of general circulation on Monday, April 13. It read in pertinent part as follows:

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7 Mollison had returned to the United States for the weekend. Friday morning, April 10, he had been on the Kidd tract "and had been advised by defendant Holyk as to the drilling results to 7:00 p.m. on April 10. At that time drill holes K-55-1, K-55-3 and K-55-4 had been completed; drilling of K-55-5 had started on Section 2200 S and had been drilled to 97 feet, encountering mineralization on the last 42 feet; and drilling of K-55-6 had been started on Section 2400 S and had been drilled to 569 feet, encountering mineralization over the last 127 feet." *Id.* at 294.

NEW YORK, April 12—The following statement was made today by Dr. Charles F. Fogarty, executive vice president of Texas Gulf Sulphur Company, in regard to the company's drilling operations near Timmins, Ontario, Canada. Dr. Fogarty said:

"During the past few days, the exploration activities of Texas Gulf Sulphur in the area of Timmins, Ontario, have been widely reported in the press, coupled with rumors of a substantial copper discovery there. These reports exaggerate the scale of operations, and mention plans and statistics of size and grade of ore that are without factual basis and have evidently originated by speculation of people not connected with TGS.

"The facts are as follows. TGS has been exploring in the Timmins area for six years as part of its overall search in Canada and elsewhere for various minerals—lead, copper, zinc, etc. During the course of this work, in Timmins as well as in Eastern Canada, TGS has conducted exploration entirely on its own, without the participation by others. Numerous prospects have been investigated by geophysical means and a large number of selected ones have been core-drilled. These cores are sent to the United States for assay and detailed examination as a matter of routine and on advice of expert Canadian legal counsel. No inferences as to grade can be drawn from this procedure.

"Most of the areas drilled in Eastern Canada have revealed either barren pyrite or graphite without value; a few have resulted in discoveries of small or marginal sulphide ore bodies.

"Recent drilling on one property near Timmins has led to preliminary indications that more drilling would

be required for proper evaluation of this prospect. The drilling done to date has not been conclusive, but the statements made by many outside quarters are unreliable and include information and figures that are not available to TGS.

"The work done to date has not been sufficient to reach definite conclusions and any statement as to size and grade of ore would be premature and possibly misleading. When we have progressed to the point where reasonable and logical conclusions can be made, TGS will issue a definite statement to its stockholders and to the public in order to clarify the Timmins project."

* * * * *

The release purported to give the Timmins drilling results as of the release date, April 12. From Mollison Fogarty had been told of the developments through 7:00 P.M. on April 10, and of the remarkable discoveries made up to that time, detailed *supra*, which discoveries, according to the calculations of the experts who testified for the SEC at the hearing, demonstrated that TGS had already discovered 6.2 to 8.3 million tons of proven ore having gross assay values from $26 to $29 per ton. TGS experts, on the other hand, denied at the hearing that proven or probable ore could have been calculated on April 11 or 12 because there was then no assurance of continuity in the mineralized zone.

The evidence as to the effect of this release on the investing public was equivocal and less than abundant. On April 13 the New York Herald Tribune in an article head-noted "Copper Rumor Deflated" quoted from the TGS release of April 12 and backtracked from its original April 11 report

of a major strike but nevertheless inferred from the TGS release that "recent mineral exploratory activity near Timmins, Ontario, has provided preliminary favorable results, sufficient at least to require a step-up in drilling operations." Some witnesses who testified at the hearing stated that they found the release encouraging. On the other hand, a Canadian mining security specialist, Roche, stated that "earlier in the week [before April 16] we had a Dow Jones saying that they [TGS] didn't have anything basically" and a TGS stock specialist for the Midwest Stock Exchange became concerned about his long position in the stock after reading the release. The trial court stated only that "While, in retrospect, the press release may appear gloomy or incomplete, this does not make it misleading or deceptive on the basis of the facts then known." *Id.* at 296.

Meanwhile, drilling operations continued. By the morning of April 13, in K-55-5, the fifth drill hole, substantial copper mineralization had been encountered to the 580 foot mark, and the hole was subsequently drilled to a length of 757 feet without further results. Visual estimates revealed an average content of 0.82% copper and 4.2% zinc over a 525-foot section. Also by 7:00 A.M. on April 13, K-55-6 had found mineralization to the 946-foot mark. On April 12 a fourth drill rig began to drill K-55-7, which was drilled westerly at a 45° angle, at the eastern edge of the anomaly. The next morning the 137 foot mark had been reached, fifty feet of which showed mineralization. By 7:00 P.M. on April 15, the hole had been completed to a length of 707 feet but had only encountered additional mineralization during a 26-foot length between the 425 and 451-foot marks. A mill test hole, K-55-8, had been drilled and was complete by the evening of April 13 but its mineralization had not been reported upon prior to April

16. K-55-10 was drilled westerly at a 45° angle commencing April 14 and had encountered mineralization over 231 of its 249-foot length by the evening of April 15. It, too, was drilled at the anomaly's eastern edge.

While drilling activity ensued to completion, TGS officials were taking steps toward ultimate disclosure of the discovery. On April 13, a previously-invited reporter for The Northern Miner, a Canadian mining industry journal, visited the drillsite, interviewed Mollison, Holyk and Darke, and prepared an article which confirmed a 10 million ton ore strike. This report, after having been submitted to Mollison and returned to the reporter unamended on April 15, was published in the April 16 issue. A statement relative to the extent of the discovery, in substantial part drafted by Mollison, was given to the Ontario Minister of Mines for release to the Canadian media. Mollison and Holyk expected it to be released over the airways at 11 P.M. on April 15th, but, for undisclosed reasons, it was not released until 9:40 A.M. on the 16th. An official detailed statement, announcing a strike of at least 25 million tons of ore, based on the drilling data set forth above, was read to representatives of American financial media from 10:00 A.M. to 10:10 or 10:15 A.M. on April 16, and appeared over Merrill Lynch's private wire at 10:29 A.M. and, somewhat later than expected, over the Dow Jones ticker tape at 10:54 A.M.

Between the time the first press release was issued on April 12 and the dissemination of the TGS official announcement on the morning of April 16, the only defendants before us on appeal who engaged in market activity were Clayton and Crawford and TGS director Coates. Clayton ordered 200 shares of TGS stock through his Canadian

broker on April 15 and the order was executed that day over the Midwest Stock Exchange. Crawford ordered 300 shares at midnight on the 15th and another 300 shares at 8:30 A.M. the next day, and these orders were executed over the Midwest Exchange in Chicago at its opening on April 16. Coates left the TGS press conference and called his broker son-in-law Haemisegger shortly before 10:20 A.M. on the 16th and ordered 2,000 shares of TGS for family trust accounts of which Coates was a trustee but not a beneficiary; Haemisegger executed this order over the New York and Midwest Exchanges, and he and his customers purchased 1500 additional shares.

During the period of drilling in Timmins, the market price of TGS stock fluctuated but steadily gained overall. On Friday, November 8, when the drilling began, the stock closed at 17⅜; on Friday, November 15, after K-55-1 had been completed, it closed at 18. After a slight decline to 16⅜ by Friday, November 22, the price rose to 20⅞ by December 13, when the chemical assay results of K-55-1 were received, and closed at a high of 24⅛ on February 21, the day after the stock options had been issued. It had reached a price of 26 by March 31, after the land acquisition program had been completed and drilling had been resumed, and continued to ascend to 30⅛ by the close of trading on April 10, at which time the drilling progress up to then was evaluated for the April 12th press release. On April 13, the day on which the April 12 release was disseminated, TGS opened at 30⅛, rose immediately to a high of 32 and gradually tapered off to close at 30⅞. It closed at 30¼ the next day, and at 29⅜ on April 15. On April 16, the day of the official announcement of the Timmins discovery, the price climbed to a high of 37 and closed at 36⅜. By May 15, TGS stock was selling at 58¼.

I. The Individual Defendants

A. *Introductory*

Rule 10b-5, 17 CFR 240.10b-5, on which this action is predicated, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

Rule 10b-5 was promulgated pursuant to the grant of authority given the SEC by Congress in Section 10(b) of the Securities Exchange Act of 1934 (15 U. S. C. 78j(b).[8]

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8 15 U. S. C. §78j reads in pertinent part as follows:

> §78j. Manipulative and deceptive devices
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device

By that Act Congress purposed to prevent inequitable and unfair practices and to insure fairness in securities transactions generally, whether conducted face-to-face, over the counter, or on exchanges, see 3 Loss, Securities Regulation 1455-56 (2d ed. 1961). The Act and the Rule apply to the transactions here, all of which were consummated on exchanges. See *List* v. *Fashion Park, Inc.*, 340 F. 2d 457, 461-62 (2 Cir.), *cert. denied*, 382 U. S. 811 (1965); *Cochran* v. *Channing Corp.*, 211 F. Supp. 239, 243 (SDNY 1962). Whether predicated on traditional fiduciary concepts, see, e.g., *Hotchkiss* v. *Fisher*, 16 P. 2d 531 (Kan. 1932), or on the "special facts" doctrine, see, e.g., *Strong* v. *Repide*, 213 U. S. 419 (1909), the Rule is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information, see Cary, Insider Trading in Stocks, 21 Bus. Law. 1009, 1010 (1966), Fleischer, Securities Trading and Corporation Information Practices: The Implications of the Texas Gulf Sulphur Proceeding, 51 Va. L. Rev. 1271, 1278-80 (1965). The essence of the Rule is that anyone who, trading for his own account in the securities of a corporation has "access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone" may not take "advantage of such information knowing it is unavailable to those with whom he is dealing," i.e., the investing public. *Matter of Cady, Roberts & Co.*, 40 SEC 907, 912 (1961). Insiders, as directors or management officers are, of course, by this Rule, precluded from so unfairly dealing, but the Rule is also applicable to one

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or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

possessing the information who may not be strictly termed an "insider" within the meaning of Sec. 16(b) of the Act. *Cady, Roberts, supra.* Thus, anyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed. So, it is here no justification for insider activity that disclosure was forbidden by the legitimate corporate objective of acquiring options to purchase the land surrounding the exploration site; if the information was, as the SEC contends, material,[9] its possessors should have kept out of the market until disclosure was accomplished. *Cady, Roberts, supra* at 911.

B. *Material Inside Information*

An insider is not, of course, always foreclosed from investing in his own company merely because he may be more familiar with company operations than are outside investors. An insider's duty to disclose information or his duty to abstain from dealing in his company's securities arises only in "those situations which are essentially extraordinary in nature and which are reasonably certain to have a substantial effect on the market price of the security if [the extraordinary situation is] disclosed." Fleischer, Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding, 51 Va. L. Rev. 1271, 1289.

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9 Congress intended by the Exchange Act to eliminate the idea that the use of inside information for personal advantage was a normal emolument of corporate office. See Sections 2 and 16 of the Act; H. R. Rep. No. 1383, 73rd Cong., 2d Sess. 13 (1934); S. Rep. No. 792, 73rd Cong., 2d Sess. 9 (1934); S. E. C., Tenth Annual Report 50 (1944). See *Cady, Roberts, supra* at 912.

Nor is an insider obligated to confer upon outside investors the benefit of his superior financial or other expert analysis by disclosing his educated guesses or predictions. 3 Loss, *op. cit. supra* at 1463. The only regulatory objective is that access to material information be enjoyed equally, but this objective requires nothing more than the disclosure of basic facts so that outsiders may draw upon their own evaluative expertise in reaching their own investment decisions with knowledge equal to that of the insiders.

This is not to suggest, however, as did the trial court, that "the test of materiality must necessarily be a conservative one, particularly since many actions under Section 10(b) are brought on the basis of hindsight," 258 F. Supp. 262 at 280, in the sense that the materiality of facts is to be assessed solely by measuring the effect the knowledge of the facts would have upon prudent or conservative investors. As we stated in *List* v. *Fashion Park, Inc.*, 340 F. 2d 457, 462, "The basic test of materiality . . . is whether a *reasonable* man would attach importance . . . in determining his choice of action in the transaction in question. Restatement, Torts §538(2)(a); accord Prosser, Torts 554-55; I Harper & James, Torts 565-66." (Emphasis supplied.) This, of course, encompasses any fact ". . . which in reasonable and objective contemplation *might* affect the value of the corporation's stock or securities. . . ." *List* v. *Fashion Park, Inc., supra* at 462, quoting from *Kohler* v. *Kohler Co.*, 319 F. 2d 634, 642 (7 Cir. 1963). (Emphasis supplied.) Such a fact is a material fact and must be effectively disclosed to the investing public prior to the commencement of insider trading in the corporation's securities. The speculators and chartists of Wall and Bay Streets are also "reasonable" investors entitled to the same

legal protection afforded conservative traders.[10] Thus, material facts include not only information disclosing the earnings and distributions of a company but also those facts which affect the probable future of the company and those which may affect the desire of investors to buy, sell, or hold the company's securities.

In each case, then, whether facts are material within Rule 10b-5 when the facts relate to a particular event and are undisclosed by those persons who are knowledgeable thereof will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity. Here, notwithstanding the trial court's conclusion that the results of the first drill core, K-55-1, were "too 'remote' . . . to have had any significant impact on the market, i.e., to be deemed material,"[11] 258 F. Supp. at 283, knowledge of the possibility, which surely was

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10 The House of Representatives committee that reported out the bill which eventually became the Act did so with the observation that "no investor, *no speculator*, can safely buy and sell securities upon exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells." H. R. Rep. No. 1383, 73d Cong., 2d Sess. (1934), p. 11. (Emphasis supplied.)

Dr. Bellemore, the Texas Gulf defendants' expert witness, has written: "The intelligent speculator assumes that facts are available for a thorough analysis. The speculator then examines the facts to discover and evaluate the risks that are present. He then balances these risks against the apparent opportunities for capital gains and makes his decision accordingly. He is, to the best of his ability, taking calculated risks." Bellemore, Investments: Principles, Practices and Analysis 4 (2d ed. 1962).

11 We are not, of course, bound by the trial court's determination as to materiality unless we find it "clearly erroneous" for that standard of appellate review is applicable only to issues of basic fact and not to issues of ultimate fact. See *Baranow* v. *Gibraltar Factors Corp.*, 366 F. 2d 584, 587 (2 Cir. 1966); *Mamiye Bros.* v. *Barber S.S. Lines, Inc.*, 360 F. 2d 774, 776-78 (2 Cir.), cert. denied, 385 U. S. 835 (1966); see also *SEC* v. *R. A. Holman & Co.*, 366 F. 2d 456, 457-58 (2 Cir. 1966) (by implication).

more than marginal, of the existence of a mine of the ast magnitude indicated by the remarkably rich drill cor o- cated rather close to the surface (suggesting minea v by the less expensive open-pit method) within the con of a large anomaly (suggesting an extensive region mineralization) might well have affected the price of TG. stock and would certainly have been an important fact to a reasonable, if speculative, investor in deciding whether he should buy, sell, or hold. After all, this first drill core was "unusually good and . . . excited the interest and speculation of those who knew about it." 258 F. Supp. at 282.

Our disagreement with the district judge on this issue does not, then, go to his findings of basic fact, as to which the "clearly erroneous" rule would apply, but to his understanding of the legal standard applicable to them. See *In re Hygrade Envelope Corp.*, 366 F. 2d 584, 587-89 (2 Cir. 1966), and cases cited in footnote 11 *supra*. Our survey of the facts found below conclusively establishes that knowledge of the results of the discovery hole, K-55-1, would have been important to a reasonable investor and might have affected the price of the stock.[12] On April 16, *The Northern Miner*, a trade publication in wide circulation among mining stock specialists, called K-55-1, the discovery hole, "one of the most impressive drill holes completed in

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12 We do not suggest that material facts must be disclosed immediately; the timing of disclosure is a matter for the business judgment of the corporate officers entrusted with the management of the corporation within the affirmative disclosure requirements promulgated by the exchanges and by the SEC. Here, a valuable corporate purpose was served by delaying the publication of the K-55-1 discovery. We do intend to convey, however, that where a corporate purpose is thus served by withholding the news of a material fact, those persons who are thus quite properly true to their corporate trust must not during the period of non-disclosure deal personally in the corporation's securities or give to outsiders confidential information not generally available to all the corporations' stockholders and to the public at large.

modern times."[13] Roche, a Canadian broker whose firm specialized in mining securities, characterized the importance to investors of the results of K-55-1. He stated that the completion of "the first drill hole" with "a 600 foot drill core is very very significant . . . anything over 200 feet is considered very significant and 600 feet is just beyond your wildest imagination." He added, however, that it "is a natural thing to buy more stock once they give you the first drill hole." Additional testimony revealed that the prices of stocks of other companies, albeit less

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13 The April 16th article in The Northern Miner resulted from the reporter's April 13th visit to the drill site where he interviewed defendants Mollison, Holyk and Darke and looked at records of the drilling to that time. The text of the article was approved by Mollison in Timmins on April 15th. The first five paragraphs read as follows:

Should Make Substantial Open Pit Operation

TEXAS GULF SULPHUR COMES UP WITH A "MAJOR"

See Big Tonnages Of Base Metals, Plus Silver

Texas Gulf Sulphur has chalked up a brilliant exploration success in its field program north of the Porcupine area. Following a visit to the discovery property, The Northern Miner can say that a major new zinc-copper-silver mine is definitely in the making, one that has all the earmarks of shaping into a substantial open pit operation.

Only a relative handful of holes has been completed since the discovery hole but on the basis of seven tests either completed or drilling it can be stated that a strike length of 600 ft. minimum has been established, showing an ore width of roughly 300 ft. which has been traced so far to a maximum vertical depth of about 800 ft.

So recent has been the discovery, and so urgent the effort to accelerate the drill program (four machines have been moved in since the discovery hole was completed), that assays have been completed on only the discovery. But this must be recorded as one of the most impressive drill holes completed in modern times.

For a core length of a shade better than 600 ft., the hole averaged in excess of 1% copper, 8% zinc and nearly four ounces of silver.

And there are impressive, strong sections within this width which in themselves are quite spectacular. In the upper part of the hole, for example, a core length of 82 ft. ran 7.1% copper, 9.7% zinc and 2.4 ozs. silver. This was followed by continuous values of ore tenor—deeper down, a 100-ft. section runs 0.33% copper, 0.8% lead, 14.3% zinc and 4.2 ozs. silver. And still deeper, a strong zinc section of better than 100 ft. averaged out to in excess of seven ounces of silver in addition to ore-grade zinc values.

diversified, smaller firms, had increased substantially solely on the basis of the discovery of good anomalies or even because of the proximity of their lands to the situs of a potentially major strike.

Finally, a major factor in determining whether the K-55-1 Discovery was a material fact is the importance attached to the drilling results by those who knew about it. In view of other unrelated recent developments favorably affecting TGS, participation by an informed person in a regular stock-purchase program, or even sporadic trading by an informed person, might lend only nominal support to the inference of the materiality of the K-55-1 discovery; nevertheless, the timing by those who knew of it of their stock purchases and their purchases of *short-term* calls—purchases in some cases by individuals who had never before purchased calls or even TGS stock—virtually compels the inference that the insiders were influenced by the drilling results. This insider trading activity, which surely constitutes highly pertinent evidence and the only truly objective evidence of the materiality of the K-55-1 discovery, was apparently disregarded by the court below in favor of the testimony of defendants' expert witnesses, all of whom "agreed that one drill core does not establish an ore body, much less a mine," 258 F. Supp. at 282-283. Significantly, however, the court below, while relying upon what these defense experts said the defendant insiders *ought* to have thought about the worth to TGS of the K-55-1 discovery, and finding that from November 12, 1963 to April 6, 1964 Fogarty, Murray, Holyk and Darke spent more than $100,000 in purchasing TGS stock and calls on that stock, made no finding that the insiders were motivated by any factor other than the extraordinary K-55-1 discovery when they bought their stock and their calls. No reason appears why outside investors, perhaps better acquainted with spec-

ulative modes of investment and with, in many cases, perhaps more capital at their disposal for intelligent speculation, would have been less influenced, and would not have been similarly motivated to invest if they had known what the insider investors knew about the K-55-1 discovery.

Our decision to expand the limited protection afforded outside investors by the trial court's narrow definition of materiality is not at all shaken by fears that the elimination of insider trading benefits will deplete the ranks of capable corporate managers by taking away an incentive to accept such employment. Such benefits, in essence, are forms of secret corporate compensation, see Cary, Corporate Standards and Legal Rules, 50 Calif. L. Rev. 408, 409-10 (1962), derived at the expense of the uninformed investing public and not at the expense of the corporation which receives the sole benefit from insider incentives. Moreover, adequate incentives for corporate officers may be provided by properly administered stock options and employee purchase plans of which there are many in existence. In any event, the normal motivation induced by stock ownership, i.e., the identification of an individual with corporate progress, is ill-promoted by condoning the sort of speculative insider activity which occurred here; for example, some of the corporation's stock was sold at market in order to purchase short-term calls upon that stock, calls which would never be exercised to increase a stockholder equity in TGS unless the market price of that stock rose sharply.

The core of Rule 10b-5 is the implementation of the Congressional purpose that all investors should have equal access to the rewards of participation in securities transactions. It was the intent of Congress that all members of the investing public should be subject to identical market risks,—which market risks include, of course the risk that one's evaluative capacity or one's capital available to put

at risk may exceed another's capacity or capital. The insiders here were not trading on an equal footing with the outside investors. They alone were in a position to evaluate the probability and magnitude of what seemed from the outset to be a major ore strike; they alone could invest safely, secure in the expectation that the price of TGS stock would rise substantially in the event such a major strike should materialize, but would decline little, if at all, in the event of failure, for the public, ignorant at the outset of the favorable probabilities would likewise be unaware of the unproductive exploration, and the additional exploration costs would not significantly affect TGS market prices. Such inequities based upon unequal access to knowledge should not be shrugged off as inevitable in our way of life, or, in view of the congressional concern in the area, remain uncorrected.

We hold, therefore, that all transactions in TGS stock or calls by individuals apprised of the drilling results[14] of K-55-1 were made in violation of Rule 10b-5.[15] Inasmuch as the visual evaluation of that drill core (a generally reliable estimate though less accurate than a chemical assay) constituted material information, those advised of the results of the visual evaluation as well as those informed of the chemical assay traded in violation of law. The geologist Darke possessed undisclosed material information and

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14 The trial court found that defendant Murray "had no detailed knowledge as to the work" on the Kidd-55 segment. There is no evidence in the record suggesting that Murray purchased his stock on January 8, 1964, on the basis of material undisclosed information, and the disposition below is undisturbed as to him.

15 Even if insiders were in fact ignorant of the broad scope of the Rule and acted pursuant to a mistaken belief as to the applicable law such an ignorance does not insulate them from the consequences of their acts. *Tager* v. *SEC*, 344 F. 2d 5, 8 (2 Cir. 1965).

traded in TGS securities. Therefore we reverse the dismissal of the action as to him and his personal transactions. The trial court also found, 258 F. Supp. at 284, that Darke, after the drilling of K-55-1 had been completed and with detailed knowledge of the results thereof, told certain outside individuals that TGS "was a good buy." These individuals thereafter acquired TGS stock and calls. The trial court also found that later, as of March 30, 1964, Darke not only used his material knowledge for his own purchases but that the substantial amounts of TGS stock and calls purchased by these outside individuals on that day, see footnote 4, *supra,* was "strong circumstantial evidence that Darke must have passed the word to one or more of his 'tippees' that drilling on the Kidd 55 segment was about to be resumed." 258 F. Supp. at 284. Obviously if such a resumption were to have any meaning to such "tippees," they must have previously been told of K-55-1.

Unfortunately, however, there was no definitive resolution below of Darke's liability in these premises for the trial court held as to him, as it held as to all the other individual defendants, that this "undisclosed information" never became material until April 9. As it is our holding that the information acquired after the drilling of K-55-1 was material, we, on the basis of the findings of direct and circumstantial evidence on the issue that the trial court has already expressed, hold that Darke violated Rule 10b-5(3) and Section 10(b) by "tipping" and we remand, pursuant to the agreement of the parties, for a determination of the appropriate remedy.[16] As Darke's "tippees" are not defen-

16 Judges Waterman and Anderson, believing that there had been no definitive finding below as to whether Darke, expressly or by implication, transmitted to these outsiders any indication of the extremely favorable results of the drilling operation in which he was engaged, would remand

dants in this action, we need not decide whether, if they acted with actual or constructive knowledge that the material information was undisclosed, their conduct is as equally violative of the Rule as the conduct of their insider source, though we note that it certainly could be equally reprehensible.

With reference to Huntington, the trial court found that he "had no detailed knowledge as to the work" on the Kidd-55 segment, 258 F. Supp. 281. Nevertheless, the evidence shows that he knew about and participated in TGS's land acquisition program which followed the receipt of the K-55-1 drilling results, and that on February 26, 1964 he purchased 50 shares of TGS stock. Later, on March 16, he helped prepare a letter for Dr. Holyk's signature in which TGS made a substantial offer for lands near K-55-1, and on the same day he, who had never before purchased calls on any stock, purchased a call on 100 shares of TGS stock. We are satisfied that these purchases in February and March, coupled with his readily inferable and probably reliable, understanding of the highly favorable nature of preliminary operations on the Kidd segment, demonstrate that Huntington possessed material inside information such as to make his purchase violative of the Rule and the Act.

C. *When May Insiders Act?*

Appellant Crawford, who ordered[17] the purchase of TGS stock shortly before the TGS April 16 official announce-

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for a determination on this issue, and if it should be determined that Darke did make such revelations, for a determination of the appropriate remedy.

17 The effective protection of the public from insider exploitation of advance notice of material information requires that the time that an insider places an order, rather than the time of its ultimate execution, be determinative for Rule 10b-5 purposes. Otherwise, insiders would

ment, and defendant Coates, who placed orders with and communicated the news to his broker immediately after the official announcement was read at the TGS-called press conference, concede that they were in possession of material information. They contend, however, that their purchases were not proscribed purchases for the news had already been effectively disclosed. We disagree.

Crawford telephoned his orders to his Chicago broker about midnight on April 15 and again at 8:30 in the morning of the 16th, with instructions to buy at the opening of the Midwest Stock Exchange that morning. The trial court's finding that "he sought to, and did, 'beat the news,'" 258 F. Supp. at 287, is well documented by the record. The rumors of a major ore strike which had been circulated in Canada and, to a lesser extent, in New York, had been disclaimed by the TGS press release of April 12, which significantly promised the public an official detailed announcement when possibilities had ripened into actualities. The abbreviated announcement to the Canadian press at 9:40 A.M. on the 16th by the Canadian Minister of Mines and the report carried by *The Northern Miner*, parts of which had sporadically reached New York on the morning of the 16th through reports from Canadian affiliates to a few New York investment firms, are assuredly not the equivalent of the official 10-15 minute announcement which was not released to the American financial press until after 10:00 A.M. Crawford's orders had been placed before that. Be-

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be able to "beat the news," cf. Fleischer, *supra*, 51 Va. L. Rev. at 1291, by requesting in advance that their orders be executed immediately after the dissemination of a major news release but before outsiders could act on the release. Thus it is immaterial whether Crawford's orders were executed before or after the announcement was made in Canada (9:40 A.M., April 16) or in the United States (10:00 A.M.) or whether Coates's order was executed before or after the news appeared over the Merrill Lynch (10:29 A.M.) or Dow Jones (10:54 A.M.) wires.

fore insiders may act upon material information, such information must have been effectively disclosed in a manner sufficient to insure its availability to the investing public. Particularly here, where a formal announcement to the entire financial news media had been promised in a prior official release known to the media, all insider activity must await dissemination of the promised official announcement.

Coates was absolved by the court below because his telephone order was placed shortly before 10:20 A.M. on April 16, which was after the announcement had been made even though the news could not be considered already a matter of public information. 258 F. Supp. at 288. This result seems to have been predicated upon a misinterpretation of dicta in *Cady, Roberts,* where the SEC instructed insiders to "keep out of the market until the established procedures for public release of the information are *carried out* instead of hastening to execute transactions in advance of, and in frustration of, the objectives of the release," 40 SEC at 915 (emphasis supplied). The reading of a news release, which prompted Coates into action, is merely the first step in the process of dissemination required for compliance with the regulatory objective of providing all investors with an equal opportunity to make informed investment judgments. Assuming that the contents of the official release could instantaneously be acted upon,[18] at the minimum

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18 Although the only insider who acted after the news appeared over the Dow Jones broad tape is not an appellant and therefore we need not discuss the necessity of considering the advisability of a "reasonable waiting period" during which outsiders may absorb and evaluate disclosures, we note in passing that, where the news is of a sort which is not readily translatable into investment action, insiders may not take advantage of their advance opportunity to evaluate the information by acting immediately upon dissemination. In any event, the permissible timing of insider transactions after disclosures of various sorts is one of the many areas of expertise for appropriate exercise of the SEC's rule-making power, which we hope will be utilized in the future to provide some predictability or certainty for the business community.

Coates should have waited until the news could reasonably have been expected to appear over the media of widest circulation, the Dow Jones broad tape, rather than hastening to insure an advantage to himself and his oker son-in-law.[19]

D. *Is An Insider's Good Faith A Defense Under 10b-5?*

Coates, Crawford and Clayton, who ordered purchases before the news could be deemed disclosed, claim, nevertheless, that they were justified in doing so because they honestly believed that the news of the strike had become public at the time they placed their orders. However, whether the case before us is treated solely as an SEC enforcement proceeding or as a private action,[20] proof of a specific intent to defraud is unnecessary. In an enforcement proceeding for equitable or prophylactic relief, the common law standard of deceptive conduct has been modified in the interests of broader protection for the investing public so that negligent insider conduct has become unlawful. See *Berko* v. *SEC*, 316 F. 2d 137, 141-42 (2 Cir.

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19 The record reveals that news usually appears on the Dow Jones broad tape 2-3 minutes after the reporter completes dictation. Here, assuming that the Dow Jones reporter left the press conference as early as possible, 10:10 A.M., the 10-15 minute release (which took at least that long to dictate) could not have appeared on the wire before 10:22, and for other reasons unknown to us did not appear until 10:54. Indeed, even the abbreviated version of the release reported by Merrill Lynch over its private wire did not appear until 10:29. Coates, however, placed his call no later than 10:20.

20 The SEC seeks permanent injunctions restraining future proscribed activity by all the individual defendants and the corporation. The Commission also seeks court orders upon certain of the individual defendants that are essentially remedies of a private, rather than of a regulatory nature, court orders designed to have those individual defendants disgorge any profits they enjoyed from TGS stock transactions they or their "tippees" engaged in from November 12, 1963 to April 17, 1964.

1963); *SEC* v. *Capital Gains Bureau,* 375 U. S. 180, 193 (1963). A similar standard has been adopted in private actions, see, *e.g., Stevens* v. *Vowell,* 343 F. 2d 374 (10 Cir. 1965); *Ellis* v. *Carter,* 291 F. 2d 270 (9 Cir. 1961); *Royal Air Properties, Inc.* v. *Smith,* 312 F. 2d 210 (9 Cir. 1962); *Dack* v. *Shanman,* 227 F. Supp. 26 (SDNY 1964); but see, *e.g., Weber* v. *C. M. P. Corp.,* 242 F. Supp. 321 (SDNY 1965); *Thiele* v. *Shields,* 131 F. Supp. 416 (SDNY 1955), for policy reasons which seem perfectly consistent with the broad Congressional design ". . . to insure the maintenance of fair and honest markets in . . . [securities] transactions." Sec. 2 of SEC Act, 15 U. S. C. §78b, see *Kohler* v. *Kohler Co.,* 319 F. 2d 634, 642 (7 Cir. 1963); Note, 32 U. Chi. L. Rev. 824, 839-44 (1965); Note, 63 Mich. L. Rev. 1070, 1079-81 (1965).

Absent any clear indication of a legislative intention to require a showing of specific fraudulent intent, see Note, 63 Mich. L. Rev. 1070, 1075, 1076 n. 29 (1965), the securities laws should be interpreted as an expansion of the common law[21] both to effectuate the broad remedial design of Congress, see *SEC* v. *Capital Gains Research Bureau, supra* at 195, and to insure uniformity of enforcement, see Note, 32 U. Chi. L. Rev. 824, 832 n. 36 (1965), citing *McClure* v. *Borne Chemical Co.,* 292 F. 2d 824, 834 (3 Cir. 1961). Moreover, a review of other sections of the Act from which Rule 10b-5 seems to have been drawn suggests that the implementation of a standard of conduct that encompasses

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21 Even at common law, the essentially private remedy of rescission which is sought here does not require more than a showing of negligence and frequently even less than that, see Restatement, Contracts, §476, com b (1932); and the common law concept of constructive fraud still available to private plaintiffs, see *Trussell* v. *United Underwriters, Ltd.,* 228 F. Supp. 757, 772 (D. Colo. 1964), has been expanded from recklessness, see Prosser, Torts, §102 p. 715-17 (3d ed. 1964), to include non-reckless negligent misrepresentations or omissions, see Note, 63 Mich. L. Rev. 1070, 1079.

negligence as well as active fraud comports with the administrative and the legislative purposes underlying the Rule.[22] Finally, we note that this position is not, as asserted by defendants, irreconcilable with previous language in this circuit because "*some form* of the traditional scienter requirement," *Barnes* v. *Osofsky*, 373 F. 2d 269, 272 (2 Cir. 1967), (emphasis supplied), sometimes defined as "fraud," *Fischman* v. *Raytheon Mfg. Co.*, 9 F. R. D. 707 (SDNY 1949), *rev'd on other grounds*, 188 F. 2d 783, 786 (2 Cir. 1951) is preserved. This requirement, whether it be termed lack of diligence, constructive fraud, or unreasonable or negligent conduct, remains implicit in this standard, a standard that promotes the deterrence objective of the Rule.

Thus, the beliefs of Coates, Crawford and Clayton that the news of the ore strike was sufficiently public at the time of their purchase orders are to no avail if those beliefs were no reasonable under the circumstances. Crawford points to the scattered rumors of the discovery which had been circulating for some time before April 15, to the release of the information to *The Northern Miner* on April

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22 Liability under §12(2) of the Securities Act of 1933, 15 U. S. C. §77*l*(2), the language of which is strikingly similar to that of 10b-5(2), attaches from the mere fact of misrepresentation or misleading omission unless defendant proves that "he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission." The provisions of Sections 17(a)(2) and (3) of the Securities Act of 1933, 15 U. S. C. §77q(a)(2) and (3), which are virtually identical to the provisions of Rule 10b-5(2) and (3) and were, in fact, the model therefor, see *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461, 463 (2 Cir.), cert. denied, 343 U. S. 956 (1952); *Hooper* v. *Mountain States Sec. Corp.*, 282 F. 2d 195, 201 n. 4 (5 Cir. 1960), cert. denied, 365 U. S. 814 (1961), apply criminal penalties to sellers only (Rule 10b-5 was promulgated to fill this gap in enforcement, SEC Ann. Rep. 10 (1942)), and have been read, upon close scrutiny of their legislative history, as not requiring specific fraudulent intent, *SEC* v. *Van Horn*, 371 F. 2d 181, at 184-186 (7 Cir. 1966); *United States* v. *Schaefer*, 299 F. 2d 625, 629 (7 Cir. 1962) (lack of diligence is all that is required for conviction in a criminal prosecution for violation of §17(a) of the 1933 Act.

15 to be published by it on the 16th, to the arrangement made by TGS with the Ontario Minister of Mines for the release of an abbreviated report on the evening of the 15th (which did not eventuate until 9:40 A.M., April 16), and to the corporation's official announcement at 10:00 A.M. on the 16th, all of which transpired prior to an anticipated execution of his purchase orders that had been placed by him after trading had closed on the Midwest Exchange on April 15. However, the rumors and casual disclosure through Canadian media, especially in view of the April 12 gloomy or incomplete release denying the rumors and promising official confirmation, hardly sufficed to inform traders on American exchanges affected by Crawford's purchases. Moreover, the formal announcement could not reasonably have been expected to be disseminated by the time of the opening of the exchanges on the morning of April 16, when Crawford must have expected his orders would be executed.

Clayton, who was unaware of the April 16 disclosure announcement TGS was to make can, in support of his claim that the favorable news was public, rely only on the rumors and on the phone calls received by TGS prior to the placing of his order from those who seemed to have heard some version or rumors of the news. His awareness of the contents of the April 12 release renders unreasonable any claim that he believed the news was truly public.

Finally, Coates, as we have already indicated in fn. 19, *supra,* could not reasonably have expected the official release to have been disseminated when he placed his order before 10:20 for immediate execution nor were the Canadian disclosures relied on by Crawford sufficient to render the conduct of Coates permissible under the circumstances.[23]

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23 Coates's violations encompass not only his own purchases but also the purchases by his son-in-law and the customers of his son-in-law, to whom the material information was passed. See footnote 16, *supra.*

E. *May Insiders Accept Stock Options Without Disclosing Material Information To The Issuer?*

On February 20, 1964, defendants Stephens, Fogarty, Mollison, Holyk and Kline accepted stock options issued to them and a number of other top officers of TGS, although not one of them had informed the Stock Option Committee of the Board of Directors or the Board of the results of K-55-1, which information we have held was then material. The SEC sought rescission of these options. The trial court, in addition to finding the knowledge of the results of the K-55 discovery to be immaterial, held that Kline had no detailed knowledge of the drilling progress and that Holyk and Mollison could reasonably assume that their superiors, Stephens and Fogarty, who were directors of the corporation, would report the results if that was advisable; indeed all employees had been instructed not to divulge this information pending completion of the land acquisition program, 258 F. Supp. at 291. Therefore, the court below concluded that only directors Stephens and Fogarty, of the top management, would have violated the Rule by accepting stock options without disclosure, but it also found that they had not acted improperly as the information in their possession was not material. 258 F. Supp. at 292. In view of our conclusion as to materiality we hold that Stephens and Fogarty violated the Rule by accepting them. However, as they have surrendered the options and the corporation has canceled them, *supra* at 292, n. 17, we find it unnecessary to order that the injunctions prayed for be actually issued. We point out, nevertheless, that the surrender of these options after the SEC commenced the case is not a satisfaction of the SEC claim, and a determination as to whether the issuance of injunctions against Stephens and Fogarty is advisable in order to prevent or deter future violations of regulatory provi-

sions is remanded for the exercise of discretion by the trial court.

Contrary to the belief of the trial court that Kline had no duty to disclose his knowledge of the Kidd project before accepting the stock option offered him, we believe that he, a vice president, who had become the general counsel of TGS in January 1964, but who had been secretary of the corporation since January 1961, and was present in that capacity when the options were granted, and who was in charge of the mechanics of issuance and acceptance of the options, was a member of top management and under a duty before accepting his option to disclose any material information he may have possessed, and, as he did not disclose such information to the Option Committee we direct rescission of the option he received.[24] As to Holyk and

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24 The options granted on February 20, 1964 to Mollison, Holyk, and Kline were ratified by the Texas Gulf directors on July 15, 1965 after there had been, of course, a full disclosure and after this action had been commenced. However, the ratification is irrelevant here, for we would hold with the district court that a member of top management, as was Kline, is required, before accepting a stock option, to disclose material inside information which, if disclosed, might affect the price of the stock during the period when the accepted option could be exercised. Kline had known since November 1962 that K-55-1 had been drilled, that the drilling had intersected a sulphide body containing copper and zinc, and that TGS desired to acquire adjacent property.

Of course, if any of the five knowledgeable defendants had rejected his option there might well have been speculation as to the reason for the rejection. Therefore, in a case where disclosure to the grantors of an option would seriously jeopardize a corporate security, it could well be desirable, in order to protect a corporation from selling securities to insiders who are in a position to appreciate their true worth at a price which may not accurately reflect the true value of the securities and at the same time to preserve when necessary the secrecy of corporate activity, not to require that an insider possessed of undisclosed material information reject the offer of a stock option, but only to require that he abstain from exercising it until such time as there shall have been a full disclosure and, after the full disclosure, a ratification such as was voted here. However, as this suggestion was not presented to us, we do not consider it or make any determination with reference to it.

Mollison, the SEC has not appealed the holding below that they, not being then members of top management (although Mollison was a vice president) had no duty to disclose their knowledge of the drilling before accepting their options. Therefore, the issue of whether, by accepting, they violated the Act, is not before us, and the holding below is undisturbed.

II. The Corporate Defendant

Introductory

At 3:00 P.M. on April 12, 1964, evidently believing it desirable to comment upon the rumors concerning the Timmins project, TGS issued the press release quoted in pertinent part in the text at pages 3600-3601, *supra*. The SEC argued below and maintains on this appeal that this release painted a misleading and deceptive picture of the drilling progress at the time of its issuance, and hence violated Rule 10b-5(2).[25] TGS relies on the holding of the court below that "The issuance of the release produced no unusual market action" and "In the absence of a showing that the purpose of the April 12 press release was to affect the market price of TGS stock to the advantage of TGS or its insiders, the issuance of the press release did not constitute a violation of Section 10(b) or Rule 10b-5 since it was not issued 'in connection with the purchase or sale of any security'" and, alternatively, "even if it had been established that the April 12 release was issued in connec-

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25 Rule 10b-5(2) provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, . . .
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, . . .
>
> in connection with the purchase or sale of any security.

tion with the purchase or sale of any security, the Commission has failed to demonstrate that it was false, misleading or deceptive." 258 F. Supp. at 294.

Before further discussing this matter it seems desirable to state exactly what the SEC claimed in its complaint and what it seeks. The specific SEC allegation in its complaint is that this April 12 press release ". . . was materially false and misleading and was known by certain of defendant Texas Gulf's officers and employees, including defendants Fogarty, Mollison, Holyk, Darke and Clayton, to be materially false and misleading."

The specific relief the SEC seeks is, pursuant to Section 21(e) of Securities Exchange Act of 1934, 15 U. S. C. §78u(e), a permanent injunction restraining the issuance of any further materially false and misleading publicly distributed informative items.[26]

B. *The "In Connection With . . ." Requirement.*

In adjudicating upon the relationship of this phrase to the case before us it would appear that the court below used a standard that does not reflect the congressional purpose that prompted the passage of the Securities Exchange Act of 1934.

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26 The prayer for relief reads:

WHEREFORE the plaintiff prays for:

* * * * *

(5) The issuance of a final judgment permanently enjoining the defendant Texas Gulf from directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, in connection with the purchase or sale of securities, making any untrue statement of material fact or omitting to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading, namely, from issuing, publishing, distributing or otherwise disseminating materially false, misleading, inadequate or inaccurate press releases and other communications and reports concerning material facts about Texas Gulf's activities and operations.

The dominant congressional purposes underlying the Securities Exchange Act of 1934 were to promote free and open public securities markets and to protect the investing public from suffering inequities in trading, including, specifically, inequities that follow from trading that has been stimulated by the publication of false or misleading corporate information releases. Commenting on the disclosure purposes of the House bill (H. R. 9323), the bill a Committee of Conference eventually integrated with a similar Senate bill (S. 3420) to make the bill passed by both Houses of Congress that became the Securities Exchange Act of 1934, the House Committee which reported out H. R. 9323 stated:

> The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings about a situation where the market price reflects as nearly as possible a just price. Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the operation of the markets as indices of real value. *There cannot be honest markets without honest publicity.* Manipulation and dishonest practices of the market place thrive upon mystery and secrecy. The disclosure of information materially important to investors may not instantaneously be reflected in market value, but despite the intricacies of security values truth does find relatively quick acceptance on the market. That is why in many cases it is so carefully guarded. Delayed, inaccurate, and misleading reports are the tools of the unconscionable market operator and the recreant corporate official who speculate on inside information. Despite the tug

> of conflicting interests and the influence of popular groups, responsible officials of the leading exchanges have unqualifiedly recognized in theory at least the vital importance of *true and accurate corporate reporting as an essential cog in the proper functioning of the public exchanges.* Their efforts to bring about more adequate and prompt publicity have been handicapped by the lack of legal power and by the failure of certain banking and business groups to appreciate that a business that gathers its capital from the investing public has not the same right to secrecy as a small privately owned and managed business. It is only a few decades since men believed that the disclosure of a balance sheet was a disclosure of a trade secret. Today few people would admit the right of any company to solicit public funds without the disclosure of a balance sheet. (Emphasis supplied.) H. R. Rep. No. 1383, 73rd Cong., 2d Sess. 11 (1934).

Section 10b of the Act (see footnote 8, *supra*) was taken by the Conference Committee from Section 10b of the proposed Senate bill, S. 3420, and taken from it verbatim insofar as here pertinent. The only alteration made by the Conference Committee was to substitute the present closing language of Section 10b, ". . . in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors" for the closing language of the original Section 10b of S. 3420, ". . . which the Commission may declare to be detrimental to the interests of investors." 78 Cong. Rec. 10261 (1934).

The Report of the Senate Committee which presented S. 3420 to the Senate summarized Section 10b as follows:

> Subsection (b) authorizes the Commission by rules and regulations to prohibit or regulate the use of *any other manipulative or deceptive practices which it finds detrimental to the interests of the investor.* (Emphasis supplied.)
>
> S. Rep. No. 792, 73rd Cong., 2d Sess. 18 (1934).

Indeed, from its very inception, Section 10(b), and the proposed sections in H. R. 1383 and S. 3420 from which it was derived, have always been acknowledged as catch-alls. See Bromberg, Securities Law: SEC Rule 10b-5, p. 19 (1967). In the House Committee hearings on the proposed House bill, Thomas G. Corcoran, Counsel with the Reconstruction Finance Corporation and a spokesman for the Roosevelt Administration, described the broad prohibitions contained in §9(c), the section which corresponded to Section 10(b) of S. 3420 and eventually to Section 10(b) of the Act, as follows: "Subsection (c) says, 'Thou shalt not devise any other cunning devices' . . . . Of course subsection (c) is a catch-all clause to prevent manipulative devices. I do not think there is any objection to that kind of a clause. The Commission should have the authority to deal with new manipulative devices." Stock Exchange Regulation, Hearings before the House Committee on Interstate and Foreign Commerce, 73rd Cong., 2d Sess. 115 (1934). Although several other witnesses objected to the breadth of the proposed prohibition that Corcoran was supporting, the section as enacted did not in any way limit the broad scope of the "in connection with" phrase. See 3 Loss, Securities Regulation, 1424 n. 7 (2d ed. 1961).

Thus, the legislative history of Section 10(b) does not support the proposition urged upon us by Texas Gulf Sulphur that Congress intended the limited construction of the "in connection with" phrase applied by the trial court.

Moreover, comparisons of Section 10(b) with the antifraud provisions of the Securities Act of 1933 (§12(2), 15 U. S. C. §77*l*(2) "... [offers or] sells a security by means of ..."; §17(a), 15 U. S. C. §77q(a) "... in the [offer or] sale of any securities to obtain money or property by means of ..."; [language in brackets was added in 1954 amendments]), and with the 1936 antifraud amendment of Section 15 of the Securities Exchange Act of 1934 (§15(c)(1), 15 U. S. C. §78*o*(c)(1) "... effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security ...") demonstrate that when Congress intended that there be a participation in a securities transaction as a prerequisite of a violation, it knew how to make that intention clear. See Bromberg, *op. cit. supra* Table 1 at 16-17.

Therefore it seems clear from the legislative purpose Congress expressed in the Act, and the legislative history of Section 10(b) that Congress when it used the phrase "in connection with a purchase or sale of any security" intended only that the device employed, whatever it might be, be of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities. There is no indication that Congress intended that the corporations or persons responsible for the issuance of a misleading statement would not violate the section unless they engaged in related securities transactions or otherwise acted with wrongful motives; indeed, the obvious purposes of the Act to protect the investing public and to secure fair dealing in the securities markets would be seriously undermined by applying such a gloss onto the legislative language. Absent a securities transaction by an insider it is almost impossible to prove that a wrongful purpose moti-

vated the issuance of the misleading statement. The mere fact that an insider did not engage in securities transactions does not negate the possibility of wrongful purpose; perhaps the market did not react to the misleading statement as much as was anticipated or perhaps the wrongful purpose was something other than the desire to buy at a low price or sell at a high price. Of even greater relevance to the Congressional purpose of investor protection is the fact that the investing public may be injured as much by one's misleading statement containing inaccuracies caused by negligence as by a misleading statement published intentionally to further a wrongful purpose. We do not believe that Congress intended that the proscriptions of the Act would not be violated unless the makers of a misleading statement also participated in pertinent securities transactions in connection therewith, or unless it could be shown that the issuance of the statement was motivated by a plan to benefit the corporation or themselves at the expense of a duped investing public.

Nor is there anything about Rule 10b-5 which demonstrates that the SEC sought by the Rule not fully to implement the Congressional purpose and objectives underlying Section 10(b). See Securities Exchange Act of 1934, Release No. 3230 (May 21, 1942); 10 SEC Ann. Rep. 56-7 (1944); 8 SEC Ann. Rep. 10 (1942). To be sure, SEC official publicity accompanying the promulgation of the Rule emphasized the insider trading aspects of the Rule, particularly the prohibition against purchases by insiders, but this was emphasized because "the previously existing rules against fraud in the purchase of securities applied only to brokers and dealers," 8 SEC Ann. Rep. 10, and the Commission wished to make it emphatically clear that the Rule was expected, *inter alia*, to close this loophole.

The foregoing discussion demonstrates that Congress intended to protect the investing public in connection with their purchases or sales on Exchanges from being misled by misleading statements promulgated for or on behalf of corporations irrespective of whether the insiders contemporaneously trade in the securities of that corporation and irrespective of whether the corporation or its management have an ulterior purpose or purposes in making an official public release. Indeed, the Commission has been charged by Congress with the responsibility of policing all misleading corporate statements from those contained in an initial prospectus to those contained in a notice to stockholders relative to the need or desirability of terminating the existence of a corporation or of merging it with another. To render the Congressional purpose ineffective by inserting into the statutory words the need of proving, not only that the public may have been misled by the release, but also that those responsible were actuated by a wrongful purpose when they issued the release, is to handicap unreasonably the Commission in its work. We should have in mind the wise words of Judge Learned Hand in *Cawley* v. *United States*, 272 F. 2d 443, 445 (2 Cir. 1959), relative to an interpretation of the words contained within a congressional statute, that " . . . unless they explicitly forbid it, the purpose of a statutory provision is the best test of the meaning of the words chosen. We are to put ourselves so far as we can in the position of the legislature that uttered them, and decide whether or not it would declare that the situation that has arisen is within what it wishes to cover. Indeed, at times the purpose may be so manifest as to override even the explicit words used. *Markham* v. *Cabell*, 326 U. S. 404."

As was pointed out by the trial court, 258 F. Supp. at 293, the intent of the Securities Exchange Act of 1934 is

the protection of investors against fraud. Therefore, it would seem elementary that the Commission has a duty to police management so as to prevent corporate practices which are reasonably likely fraudulently to injure investors. And, of course, as we have already emphasized, a corporation's misleading material statement may injure an investor irrespective of whether the corporation itself, or those individuals managing it, are contemporaneously buying or selling the stock of the corporation. Therefore, when materially misleading corporate statements or deceptive insider activities have been uncovered, the courts, as they should, have broadly construed the statutory phrase "in connection with the purchase or sale of any security." *Freed* v. *Szabo Food Serv., Inc.*, CCH Fed. SEC L. Rep. ¶91,317 (N. D. Ill. 1964); *Stockwell* v. *Reynolds & Co.*, 252 F. Supp. 215 (SDNY 1965); *Cooper* v. *North Jersey Trust Co.*, 226 F. Supp. 972, 978 (SDNY 1964); *Miller* v. *Bargain City, U. S. A., Inc.*, 229 F. Supp. 33, 37 (E. D. Pa. 1964); see Ruder, Corporate Disclosures Required by the Federal Securities Laws: The Codification Implications of Texas Gulf Sulphur, 61 Nw. U. L. Rev. 872, 895 (1967). The court below found: "There is no evidence that TGS derived any direct benefit from the issuance of the press release or that any of the defendants who participated in its preparation used it to their personal advantage." 258 F. Supp. at 294. The requirement that a statement may not be found misleading unless its issuance is actuated by a "wrongful purpose" might well have the effect of permitting the issuers of misleading statements to seek an advantage but to escape liability if the advantage fails to materialize to the degree contemplated, or cannot be demonstrated.

More important, however, is the realization which we must again underscore at the risk of repetition, that the investing public is hurt by exposure to false or deceptive

statements irrespective of the purpose underlying their issuance.[27] It does not appear to be unfair to impose upon corporate management a duty to ascertain the truth of any statements the corporation releases to its shareholders or to the investing public at large. Accordingly, we hold that Rule 10b-5 is violated whenever assertions are made, as here, in a manner reasonably calculated to influence the investing public, e.g., by means of the financial media, Fleischer, *supra*, 51 Va. L. Rev. at 1294-95, if such assertions are false or misleading or are so incomplete as to mislead irrespective of whether the issuance of the release was motivated by corporate officials for ulterior purposes. It seems clear, however, that if corporate management demonstrates that it was diligent in ascertaining that the information it published was the whole truth and that such diligently obtained information was disseminated in good faith, Rule 10b-5 would not have been violated.

C. *Did the Issuance of the April 12 Release Violate Rule 10b-5?*

Turning first to the question of whether the release was misleading, i.e., whether it conveyed to the public a false impression of the drilling situation at the time of its issuance, we note initially that the trial court did not actually decide this question. Its conclusion that "the Commission has failed to demonstrate that it was false, misleading or deceptive," 258 F. Supp. at 294, seems to have derived from its views that "The defendants are to be judged *on the facts known to them* when the April 12 release was issued," 258 F. Supp. at 295 (emphasis supplied), that the draftsmen "exercised reasonable business judgment under the

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27 See the discussion in footnotes 20, 21, and 22, *supra*, and in the accompanying text, dispensing with a fraudulent intent requirement in actions based on clause (3) of Rule 10b-5.

circumstances," 258 F. Supp. at 296, and that the release was not "misleading or deceptive *on the basis of the facts then known*," 258 F. Supp. at 296 (emphasis supplied) rather than from an appropriate primary inquiry into the meaning of the statement to the reasonable investor and its relationship to truth. While we certainly agree with the trial court that "in retrospect, the press release may appear gloomy or incomplete," [28] 258 F. Supp. at 296, we

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28 Examined in retrospect, the situation in Timmins at the time the release was prepared seems to offer good reason for optimism. The draftsmen of the release had full knowledge of the discoveries up to 7:00 P.M. on Friday, April 10. At that time approximately 2/3 of the ore ultimately found to exist by the time of the preparation of the April 16 "major strike" release had been discovered by 5 holes placed so as to indicate continuity of mineralization within the large anomaly. As of that time SEC experts estimated ore reserves of over 8 million tons at a gross assay value (excluding costs) of over $26 a ton. Accepting the conservative view of TGS's expert Wiles that 95.2% would be absorbed by costs, the ultimate profit could then have been estimated at more than $14,000,000. TGS experts could name very few base metal mines with a greater assay value and the court observed that bodies of much lower assay value were commercially mined, 258 F. Supp. at 282 n. 10. Roche, a mining stock specialist, added that mines with significantly lower percentages of copper and with no zinc or silver, as here, were profitably operated. On the basis of approximately one-third more data, and, for all the record shows, without any additional figures as to estimated costs, TGS announced on April 16 a major strike with over 25 million tons of ore. The trial court found that as of 7:00 P.M. on Thursday, April 9, "There was real evidence that a body of commercially mineable ore might exist." 252 F. Supp. at 282. And, by 7:00 A.M. on Sunday, April 10, eight hours before the release was issued to the press, 77.9% of the drilling in mineralization had been completed, 84.4% by 7:00 P.M. on the 12th, and 90.2% by 7 A.M. on April 13. The release did not appear in most newspapers of general circulation until later in the morning of Monday, the 13th.

The release, see pp. 3600-3601 *supra*, began by referring to rumored reports that the company had made a substantial copper discovery and then continued: "These reports exaggerate the scale of operations, and mention plans and statistics of size and grade of ore that are without factual basis and have evidently originated by speculation of people not connected with TGS." It then stated, purporting to give the true facts in contradiction to the rumors: "The facts are as follows." However, the "facts" disclosed relative to the Kidd-55 segment were: "Recent drilling on one property near Timmins has led to preliminary

cannot, from the present record, by applying the standard Congress intended, definitively conclude that it was deceptive or misleading to the reasonable investor, or that he would have been misled by it. Certain newspaper accounts of the release viewed the release as confirming the existence of preliminary favorable developments, and this optimistic view was held by some brokers, so it could be that the reasonable investor would have read between the lines of what appears to us to be an inconclusive and negative statement and would have envisioned the actual situation at the Kidd segment on April 12. On the other hand, in view of the decline of the market price of TGS stock from a high of 32 on the morning of April 13 when the release was disseminated to 29⅜ by the close of trading on April 15, and the reaction to the release by other brokers, it is far from certain that the release was generally interpreted as a highly encouraging report or even encouraging at all. Accordingly, we remand this issue to the district court that took testimony and heard and saw the witnesses for a determination of the character of the release in the light of the facts existing at the time of the release, by applying the standard of whether the reasonable investor, in the exercise of due care, would have been misled by it.

In the event that it is found that the statement was misleading to the reasonable investor it will then become necessary to determine whether its issuance resulted from a lack of due diligence. The only remedy the Commission seeks against the corporation is an injunction, see footnote 26,

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indications that more drilling would be required for proper evaluation of this prospect. The drilling done to date has not been conclusive, but the statements made by many outside quarters are unreliable." It was then said that, as of April 12, the release date, ". . . any statement as to size and grade of ore would be premature and possibly misleading." A definite statement "to clarify" was promised in the future.

supra, and therefore we do not find it necessary to decide whether just a lack of due diligence on the part of TGS, absent a showing of bad faith, would subject the corporation to any liability for damages. We have recently stated in a case involving a private suit under Rule 10b-5 in which damages and an injunction were sought, " 'It is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for monetary damages.' " *Mutual Shares Corp.* v. *Genesco, Inc.,* 384 F. 2d 540, 547, quoting from *SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U. S. 180, 193 (1963).

We hold only that, in an action for injunctive relief, the district court has the discretionary power under Rule 10b-5 and Section 10(b) to issue an injunction, if the misleading statement resulted from a lack of due diligence on the part of TGS. The trial court did not find it necessary to decide whether TGS exercised such diligence and has not yet attempted to resolve this issue. While the trial court concluded that TGS had exercised "reasonable *business* judgment under the circumstances," 258 F. Supp. at 296 (emphasis supplied) it applied an incorrect *legal* standard in appraising whether TGS should have issued its April 12 release on the basis of the facts known to its draftsmen at the time of its preparation, 258 F. Supp. at 295, and in assuming that disclosure of the full underlying facts of the Timmins situation was not a viable alternative to the vague generalities which were asserted. 258 F. Supp. at 296.

It is not altogether certain from the present record that the draftsmen could, as the SEC suggests, have readily obtained current reports of the drilling progress over the weekend of April 10-12, but they certainly should have obtained them if at all possible for them to do so. However, even if it were not possible to evaluate and transmit

current data in time to prepare the release on April 12, it would seem that TGS could have delayed the preparation a bit until an accurate report of a rapidly changing situation was possible. See 258 F. Supp. at 296. At the very least, if TGS felt compelled to respond to the spreading rumors of a spectacular discovery, it would have been more accurate to have stated that the situation was in flux and that the release was prepared as of April 10 information rather than purporting to report the progress "to date." Moreover, it would have obviously been better to have specifically described the known drilling progress as of April 10 by stating the basic facts. Such an explicit disclosure would have permitted the investing public to evaluate the "prospect" of a mine at Timmins without having to read between the lines to understand that preliminary indications were favorable—in itself an understatement.

The choice of an ambiguous general statement rather than a summary of the specific facts cannot reasonably be justified by any claimed urgency. The avoidance of liability for misrepresentation in the event that the Timmins project failed, a highly unlikely event as of April 12 or April 13, did not forbid the accurate and truthful divulgence of detailed results which need not, of course, have been accompanied by conclusory assertions of success. Nor is it any justification that such an explicit disclosure of the truth might have "encouraged the rumor mill which they were seeking to allay." 258 F. Supp. at 296.

We conclude, then, that, having established that the release was issued in a manner reasonably calculated to affect the market price of TGS stock and to influence the investing public, we must remand to the district court to decide whether the release was misleading to the reasonable investor and if found to be misleading, whether the court in its discretion should issue the injunction the SEC seeks.

CONCLUSION

In summary, therefore, we affirm the finding of the court below that appellants Richard H. Clayton and David M. Crawford have violated 15 U. S. C. §78j(b) and Rule 10b-5; we reverse the judgment order entered below dismissing the complaint against appellees Charles F. Fogarty, Richard H. Clayton, Richard D. Mollison, Walter Holyk, Kenneth H. Darke, Earl L. Huntington, and Francis G. Coates, as we find that they have violated 15 U. S. C. §78j(b) and Rule 10b-5. As to these eight individuals we remand so that in accordance with the agreement between the parties the Commission may notice a hearing before the court below to determine the remedies to be applied against them. We reverse the judgment order dismissing the complaint against Claude O. Stephens, Charles F. Fogarty, and Harold B. Kline as recipients of stock options, direct the district court to consider in its discretion whether to issue injunction orders against Stephens and Fogarty, and direct that an order issue rescinding the option granted Kline and that such further remedy be applied against him as may be proper by way of an order of restitution; and we reverse the judgment dismissing the complaint against Texas Gulf Sulphur Company, remand the cause as to it for a further determination below, in the light of the approach explicated by us in the foregoing opinion, as to whether, in the exercise of its discretion, the injunction against it which the Commission seeks should be ordered.

FRIENDLY, *Circuit Judge* (concurring):

Agreeing with the result reached by the majority and with most of Judge Waterman's searching opinion, I take a rather different approach to two facets of the case.

I.

The first is a situation that will not often arise, involving as it does the acceptance of stock options during a period when inside information likely to produce a rapid and substantial increase in the price of the stock was known to some of the grantees but unknown to those in charge of the granting. I suppose it would be clear, under *Ruckle* v. *Roto American Corp.*, 339 F. 2d 24 (2 Cir. 1964),[1] that if a corporate officer having such knowledge persuaded an unknowing board of directors to grant him an option at a price approximating the current market, the option would be rescindable in an action under Rule 10b-5. It would seem, by the same token, that if, to make the pill easier to swallow, he urged the directors to include others lacking the knowledge he possessed, he would be liable for all the resulting damage. The novel problem in the instant case is to define the responsibility of officers when a directors' committee

1 Since none of the parties has raised the question, I assume the continuing vitality of *Ruckle*, despite what have been regarded as contrary intimations in *O'Neill* v. *Maytag*, 339 F. 2d 764 (2 Cir. 1964), a decision that has not found favor with other circuits. Cf. *Dasho* v. *The Susquehanna Corp.*, 380 F. 2d 262 (7 Cir.), cert. denied, 381 U. S. 977 (1967); *Pappas* v. *Moss*, 393 F. 2d 865 (3 Cir. 1968); see Jennings, Insider Trading in Corporate Securities: A Survey of Hazards and Disclosure Obligations under Rule 10b-5, 62 Nw. U. L. Rev. 809, 830-33 (1968). If we were writing on a clean slate, I would have some doubt whether the framers of the Securities Exchange Act intended §10b to provide a remedy for an evil that had long been effectively handled by derivative actions for waste of corporate assets under state law simply because in a particular case the waste took the form of a sale of securities. We will shortly be exploring this issue in the *in banc* consideration of *Schoenbaum* v. *Firstbrook*, slip opinions 2459.

administering a stock option plan proposes of its own initiative to make options available to them and others at a time when they know that the option price, geared to the market value of the stock, did not reflect a substantial increment likely to be realized in short order and was therefore unfair to the corporation.

A rule requiring a minor officer to reject an option so tendered would not comport with the realities either of human nature or of corporate life. If the SEC had appealed the ruling dismissing this portion of the complaint as to Holyk and Mollison, I would have upheld the dismissal quite apart from the special circumstance that a refusal on their part could well have broken the wall of secrecy it was important for TGS to preserve. Whatever they knew or didn't know about Timmins, they were entitled to believe their superiors had reported the facts to the Option Committee unless they had information to the contrary. Stephens, Fogarty and Kline stand on an altogether different basis; as senior officers they had an obligation to inform the Committee that this was not the right time to grant options at 95% of the current price. Silence, when there is a duty to speak, can itself be a fraud. I am unimpressed with the argument that Stephens, Fogarty and Kline could not perform this duty on the peculiar facts of this case, because of the corporate need for secrecy during the land acquisition program. Non-management directors would not normally challenge a recommendation for postponement of an option plan from the President, the Executive Vice President, and the Vice President and General Counsel. Moreover, it should be possible for officers to communicate with directors, of all people, without fearing a breach of confidence. Hence, as one of the foregoing hypotheticals suggests, I am not at all sure that a company in the position

of TGS might not have a claim against top officers who breached their duty of disclosure for the entire damage suffered as a result of the untimely issuance of options, rather than merely one for rescission of the options issued to them.[2] Since that issue is not before us, I merely make the reservation of my position clear.

II.

The second point, to me transcending in public importance all others in this important case, is the press release issued by TGS on April 12, 1964. This seems to me easier on the facts but harder on the law than it does to the majority.

No one has asserted, or reasonably could assert, that the purpose for issuing a release was anything but good. TGS felt it had a responsibility to protect would-be buyers of its shares from what it regarded as exaggerated rumors first in the Canadian and then in the New York City press, and none of the individual defendants sought to profit from the decline in the price of TGS stock caused by the release. I find it equally plain, as Judge Waterman's opinion convincingly demonstrates, that the release did not properly convey the information in the hands of the draftsmen on April 12, even granting, as I would, that in a case like this

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2 Though the Board of Directors of TGS ratified the issuance of the options after the Timmins discovery had been fully publicized, it obviously was of the belief that Kline had committed no serious wrong in remaining silent. Throughout this litigation TGS has supported the legality of the actions of all the defendants—the company's counsel having represented, among others, Stephens, Fogarty and Kline. Consequently, I agree with the majority in giving the Board's action no weight here. If a fraud of this kind may ever be cured by ratification, compare *Continental Securities* v. *Belmont*, 206 N. Y. 7 (1912), with *Claman* v. *Robertson*, 164 Ohio St. 61 (Sup. Ct. 1955); cf. *Wilko* v. *Swan*, 346 U. S. 427 (1953), that cannot be done without an appreciation of the illegality of the conduct proposed to be excused, cf. *United Hotels Co.* v. *Mealey*, 147 F. 2d 816, 819 (2 Cir. 1945).

a court should not set the standard of care too high. To say that the drilling at Timmins had afforded only "preliminary indications that more drilling would be required for proper evaluation of this prospect," was a wholly insufficient statement of what TGS knew. Cf. *Gediman* v. *Anheuser Busch, Inc.*, 299 F. 2d 537, 545 (2 Cir. 1962). Since the issue of negligence is open to full review, *Mamiye Bros.* v. *Barber SS. Lines*, 360 F. 2d 774 (2 Cir.), cert. denied, 385 U. S. 835 (1965); *Esso Standard Oil, S.A.* v. *S.S. Gasbras Sul*, 387 F. 2d 573 (2 Cir.), cert. denied, 36 L. W. 3443 (May 21, 1968), I see no need for a remand on that score. It is an equally needless exercise to require the district court to determine whether a reasonable investor would have been misled. The text of the release and the three point drop in the market price following its issuance in the face of press reports that would normally have led to a large and, as matters developed, justified increase, are sufficient proof of that.

The majority says that negligent misstatement by a corporation is enough for injunctive relief under Rule 10b-5 (2) in a proper case; it reserves the question, not here presented, whether the corporation is liable for damages. I think the remand should make crystal clear that the issue whether this is a proper case for an injunction remains open, and that with 49 private actions pending in the District Court for the Southern District of New York, see 258 F. Supp. 262, 267 n. 1 (1966), some of which may involve this issue, we should explicate more clearly why, despite the principle that a violation of the securities laws or regulations generally gives rise to a private claim for damages, see *J. I. Case Co.* v. *Borak*, 377 U. S. 426 (1964), violation of Rule 10b-5(2) may not do so under all circumstances, including those presented by the April 12 press release.

The attention this case has received from the profession and our own close consideration make it incumbent on us to give the district courts in our circuit as much guidance as we can.

A.

The consequences of holding that negligence in the drafting of a press release such as that of April 12, 1964, may impose civil liability on the corporation are frightening. As has been well said of a situation where time pressures and consequent risks were less, "One source of perplexity as to the appropriate bounds of the civil remedy for misleading filings is that any remedy imposed against the issuer itself is indirectly imposed on all holders of the common stock, usually the most important segment of the total category of investors intended to be protected." Milton Cohen, Truth in Securities Revisited, 79 Harv. L. Rev. 1340, 1370 (1966). Beyond this, a rule imposing civil liability in such cases would work directly counter to what the SEC has properly called "a commendable and growing recognition on the part of industry and the investment community of the importance of informing security holders and the public generally with respect to important business and financial developments." Securities Act Interpretation Release No. 3844 (Oct. 8, 1957). If the only choices open to a corporation are either to remain silent and let false rumors do their work, or to make a communication, not legally required, at the risk that a slip of the pen or failure properly to amass or weigh the facts—all judged in the bright gleam of hindsight—will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers, most corporations would opt for the former.

The derivation of Rule 10b-5 is peculiar. Although the authority for the Rule comes from §10b of the Securities

and Exchange Act of 1934, the draftsmen turned their backs on the language of that section and borrowed the words of §17 of the Securities Act of 1933, simply broadening these to include frauds on the seller as well as on the buyer. So far as concerns paragraphs (1) and (3), this is not very important since these are clearly within the ambit of §10b and relate to frauds that would give rise to civil liability in any event. But the case stands differently as to paragraph (2). The only provision in either the 1933 or the 1934 Act that can be read to impose liability for damages for negligent misrepresentation without restrictions as to the kinds of plaintiffs, due diligence defenses, a short statute of limitations, or an undertaking for costs that were insisted on by the investment community, is §17(a)(2) of the Act of 1933—the source of Rule 10b-5(2).[3] But there is unanimity among the commentators, including some who were in a peculiarly good position to know, that §17(a)(2) of the 1933 Act—indeed the whole of §17—was intended only to afford a basis for injunctive relief and, on a proper showing, for criminal liability, and was never believed to supplement the actions for damages provided by §§11 and 12. See Landis, Liability Sections of Securities Act, 18 Am. Acct. 330, 331 (1933); Douglas and Bates, Federal Securities Act of 1933, 43 Yale L. J. 171, 181-82 (1933); 3 Loss, Securities Regulation 1785-86 (1961). When the House Committee Report listed the sections that "define the civil liabilities imposed by the Act" it pointed only to §§11 and 12 and stated that "[t]o impose a greater responsibility [than that provided by §§11 and 12] . . . would unnecessarily restrain the conscientious administration of

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3 Of course, §12(1)'s imposition of a liability almost absolute upon the seller of a security that has not been registered in violation of §5 of the 1933 Act is grounded on distinctive concerns. See 3 Loss, Securities Regulation 1692-96 (1961).

honest business with no compensating advantage to the public." H. Rep. No. 85, 73d Cong., 1st Sess. 9-10 (1933). Once it had been established, however, that an aggrieved buyer has a private action under §10(b) of the 1934 Act, there seemed little practical point in denying the existence of such an action under §17—with the important proviso that fraud, as distinct from mere negligence, must be alleged. See *Fischman* v. *Raytheon Mfg. Corp.*, 188 F. 2d 783, 787 n. 2 (2 Cir. 1951); *Weber* v. *C. M. P. Corp.*, 242 F. Supp. 321, 322-25 (S. D. N. Y. 1965) (Wyatt, *J.*); *Thiele* v. *Shields*, 131 F. Supp. 416, 419 (S. D. N. Y. 1955) (Kaufman, *J.*); but see *Dack* v. *Shanman*, 227 F. Supp. 26 (S. D. N. Y. 1964). To go further than this, as Professor Loss powerfully argues, Securities Regulation at 1785, would totally undermine the carefully framed limitations imposed on the buyer's right to recover granted by §12(2) of the 1933 Act.

Even if, however, we were to disregard the teaching of Judge Frank in *Fischman* v. *Raytheon Mfg. Corp., supra*, 188 F. 2d at 786, and follow the lead of those Circuits that seem to have discarded the *scienter* requirement in actions for damages under Rule 10b-5,[4] *Ellis* v. *Carter*, 291 F. 2d 270, 274 (9 Cir. 1961); *Royal Air Properties, Inc.* v. *Smith*, 312 F. 2d 210, 212 (9 Cir. 1962); *Kohler* v. *Kohler Co.*, 208 F. Supp. 808, 823 (E. D. Wisc. 1962) (dictum), aff'd, 319 F. 2d 634 (7 Cir. 1962); *Stevens* v. *Vowell*, 343 F. 2d 374 (10 Cir. 1965); *Myzel* v. *Fields*, 386 F. 2d 718 (8 Cir. 1967);

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4 The imposition of liability on Clayton, Crawford and Coates for "beating the gun" does not require any such metamorphosis of Judge Frank's concept of fraud as the majority opinion seeks to perform. The only one of these defendants who came close to a showing of good faith was Coates. But even he did not act on the belief that the second press release had in fact reached the market, see 258 F. Supp. at 288; his defense was rather a belief that the law required him only to await its issuance. While such an erroneous view of the law is pardonable, it is not "good faith" in a legal sense.

we should not impose such expansive liability in a situation, markedly different from those considered in the cases just cited, where to do so would frustrate, not further, the larger goals of the securities laws. While I am not convinced that imposition of liability for damages under Rule 10b-5(2), absent a *scienter* requirement, even limited in the way just proposed, would not go beyond the authority vested in the Commission by §10b to act against "any manipulative or deceptive device or contrivance" and be so inconsistent with the general structure of the statutes as to be impermissible, it is at least clear that the April 12 press release would be the worst possible case for the award of damages for merely negligent misstatement, as distinguished from the kind of recklessness that is equivalent to wilful fraud, see *SEC* v. *Frank*, 388 F. 2d 486, 489 (2 Cir. 1968).

The issue here, however, is the different one of an injunction. Mr. Justice Goldberg noted in *SEC* v. *Capital Gains Research Bureau*, 375 U. S. 180, 193 (1963), that the elements of a cause of action for "fraud" vary "with the nature of the relief sought" and that "It is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for money damages." See also *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F. 2d 540, 547 (2 Cir. 1968). It can, indeed, be argued that, even on this basis, Rule 10b-5(2), absent the reading in of a *scienter* requirement, goes beyond the authority granted by §10b of the 1934 Act. However, it cannot be doubted that one of the most important purposes of the securities legislation was to prevent improper information being circulated by the issuer, and I therefore am not disposed to hold that Congress meant to deny a power whose use in appropriate cases can be of such great public benefit and do so little harm to legitimate activity.

B.

However, it does not necessarily follow that this is an appropriate case for granting an injunction as to future press releases. While we have often said that "a cessation of the alleged objectionable activities by the defendant in contemplation of an SEC suit will not defeat the district court's power to grant an injunction restraining continued activity," *SEC* v. *Boren*, 283 F. 2d 312 (2 Cir. 1960), and cases there cited, it is likewise true that an isolated violation, especially in the absence of bad faith, does not *require* such relief. *SEC* v. *Torr*, 87 F. 2d 446 (2 Cir. 1937). Absent much clearer language than is found in the 1934 Act, the entitlement of a plaintiff to an injunction thereunder remains subject to principles of equitable discretion. The Supreme Court made this clear beyond peradventure in the leading case of *Hecht Co.* v. *Bowles*, 321 U. S. 321 (1944). See 3 Loss, Securities Regulation 1975-83 (1961). Here there is no danger of repetition of an unduly gloomy press release like that of April 12. The essence of the SEC's case is that Timmins was a once-in-a-lifetime affair; the company's motive in issuing the release was laudable; and the defect was solely a pardonable one of execution. If Judge Bonsal had denied an injunction on these grounds, I see no basis on which we could properly have reversed him. Instead he acted on the view, erroneous in the court's belief, that no violation of the Rule had occurred and he was thus without power to enjoin, 259 F. Supp. 296. Although I see no reason why we could not affirm nevertheless, I am content to leave it for him to consider whether, although he has power to issue an injunction, there is equity in this portion of the bill. My concurrence in the disposition of the press release issue assumes that such consideration is permitted.

KAUFMAN, *Circuit Judge* (concurring):

I concur in Judge Waterman's reasoned and thorough opinion and in the court's disposition of the instant appeal. I agree with Judge Friendly, however, that we should provide guidance to the District Courts with respect to pending private claims for damages based upon Rule 10(b)(5) arising out of the transactions now before us. And, I concur in as much as Part II of Judge Friendly's opinion as discusses the origins of the rule and the relevance of today's decision —involving only an application by the S. E. C. for an injunction—to private damage actions.

ANDERSON, *Circuit Judge* (concurring):

I concur in Judge Waterman's majority opinion and I concur in the discussion of law set forth in Part II of Judge Friendly's concurring opinion.

HAYS, *Circuit Judge* (concurring in part and dissenting in part):

I concur generally with Judge Waterman in his views as to the proper interpretation of Section 10(b) and Rule 10b-5 and as to the standards which are to be employed in the application of the statute and the rule.

With the exception of Stephens and Fogarty as recipients of stock options, I agree with the majority on the disposition of the cases involving individuals.

I do not agree on the remand of the issue with respect to Stephens and Fogarty as recipients of stock options. It seems to me clear that the injunction sought by the Commission should be granted.

The majority remand the case against the corporate defendant to the district court for a determination as to

whether the April 12 press release was misleading and whether, if so, those responsible for the release used due diligence.

In my opinion the evidence establishes as a matter of law that the press release was misleading. Indeed, if the correct standard is applied, the finding of the trial court requires the conclusion that the press release was misleading:

> "At 7:00 p.m. on April 9, those with knowledge of the drilling results had material information which it was reasonably certain, if disclosed, would have had a substantial impact on the market price of TGS stock."

The evidence in the record in support of this finding is overwhelming.

Assuming arguendo that the corporation cannot be enjoined except on a showing of lack of due diligence, since Fogarty and those who assisted him in the preparation of the press release were aware of the drilling results to which the district court's finding refers, they obviously did not use due diligence in the preparation of the misleading press release.

I would grant the application for an injunction.

MOORE, *Circuit Judge* (dissenting) (with whom Chief Judge Lumbard concurs):

In their opinion, the majority have become so involved in usurping the function of the trial court, in selecting the witnesses they (at variance with the trial court) choose to believe, in forming their own factual conclusions from the evidence (in disregard of Rule 52a), in deciding with, of course, the benefit of the wisdom of hindsight, how they, had they been executives of Texas Gulf Sulphur Company (TGS), would have handled the publicity attendant to the

exploration of the Timmins property, in determining (to their own satisfaction) the motives which prompted each of the individual defendants to buy TGS stock and in becoming mining engineering experts in their own right, that I find it desirable—in fact, essential—to state my opinion as to the fundamental jurisdiction of the Court of Appeals and the issues properly before us. Primarily, our task should be to review errors of law. Conversely, we are not a jury of nine with no requirement of a unanimous verdict.

If the facts are to be reappraised by an appellate court, they should be measured *mutatis mutandis* in accordance with the standard set for himself by an experienced and learned trial judge who stated his approach in a case charging directors with wrongdoing, as follows:

> "The Court has endeavored * * * to judge the transactions in issue in this case by the applicable legal standards but without the benefit of hindsight as to the facts." (Herlands, *D.J., in Marco, etc.* v. *The Bank of New York, etc.*, 272 F. Supp. 636, 639 (S. D. N. Y., 1967).)

More, specifically, the Court in *Marco* said:

> "The Court is asked by plaintiff, in effect, to substitute its judgment for that of the directors with respect to transactions affecting the internal affairs of the corporation in question. * * * As directors they were, of course, required to perform their duties in accordance with the high standards of fidelity, honesty and prudence applicable to fiduciaries." (p. 639)

The Securities and Exchange Commission (referred to as the "SEC" and "Commission"), as an agency of government, has the responsibility of prosecuting persons who,

and corporations which, in its judgment have violated laws which the Congress has enacted for the praiseworthy purpose of protecting the public from securities frauds. However, as such an enforcement agency, where it assumes a plaintiff's role it must bear the evidentiary fair preponderance burden of all litigants and be subject to the rule that the determination of what evidence is "credible" is for the trial judge.

The Issues

The case logically and chronologically can be divided into two parts: (1) the purchase of TGS stock by individual defendants and stock options issued to them between November 12, 1963 and April 9, 1964, and (2) the TGS press release of April 12, 1964. The stock purchases by Clayton, Crawford and Coates on April 16, 1964, are considered later.

(1) In resolving the stock purchase issue, the primary factual inquiry must be concentrated on (a) the nature and extent of the knowledge possessed by, or available to, the purchaser on the date of purchase, and (b) the position of the purchaser in relation to TGS. The primary legal issue in substance is what duty, if any, rested upon the purchasers to disclose the knowledge they possessed at the time of purchase. The Commission argues that there was a failure to disclose material information. The trial court based its opinion largely upon the lack of materiality of such exploration results as were known between November 12, 1963 and April 9, 1964.

(2) Was the TGS press release of April 12, 1964, false, misleading or deceptive within the meaning of Section 10(b) and Rule 10b-5 in the light of TGS' then knowledge and the then existing factual situation.

The Facts

By-passing momentarily the general knowledge possessed by the officers of TGS as to the far-flung nature of the company's operations, its heavy concentration in the sulphur field, its non-engagement in the field of copper mining, the adverse effect which low sulphur prices had had for many years on the company's earnings despite substantial sales and focusing attention solely upon the Timmins property, the participants in that exploration and the knowledge available to them, I find no factual disputes of importance.

On November 8, 1963, TGS, selecting the most promising area of the one-quarter section then controlled by it, referred to as Kidd 55, drilled an exploratory hole, 1⅛ inches in diameter. All the information that was available upon the completion of the drilling, November 12, 1963, was contained in a core (denominated K-55-1) which was visually examined by Dr. Walter Holyk, Chief Geologist for TGS, and by Kenneth H. Darke, a TGS geologist. This core was unusually good in mineral content. The President, Claude O. Stephens, the Executive Vice-President, Charles F. Fogarty, and the Exploration Vice-President, Richard D. Mollison, were notified, and Fogarty and Mollison flew to the drill site.

In order to acquire the other three-quarters of the K-55 segment, further drilling was discontinued except for one hole drilled to produce a barren core and the site was camouflaged. Thus, but for a chemical assay made in December 1963 of contents of this same core, no other knowledge of the nature and possible extent of the area was available during the acquisition program.

Rule 52(a) should be given particular weight where expert testimony must of necessity play an important role. Here the trial court had an opportunity not only to hear

the qualifications of the experts but also from their demeanor and responses to form its opinion as to their credibility. The importance of this opportunity to observe where technical or scientific problems are before the court, as here, has been succinctly stated by the Supreme Court in *Graver Tank & Mfg. Co.* v. *Linde Air Prods. Co.*, 339 U. S. 605 (1950):

> "Like any other issue of fact, final determination requires a balancing of credibility, persuasiveness and weight of evidence. It is to be decided by the trial court and that court's decision, under general principles of appellate review, should not be disturbed unless clearly erroneous. Particularly is this so in a field where so much depends upon familiarity with specific scientific problems and principles not usually contained in the general storehouse of knowledge and experience." (pp. 609-610)
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> * * * * *
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> "It is not for this Court [the Supreme Court] to even essay an independent evaluation of this evidence. This is the function of the trial court. And, as we have heretofore observed, 'To no type of case is this . . . more appropriately applicable than to the one before us, where the evidence is largely the testimony of experts as to which a trial court may be enlightened by scientific demonstrations. * * *' 336 U. S. 271, 274-5." (p. 611)

No more is it for this court to make an independent essay of the evidence or of the core. Wanting the knowledge requisite to making our own appraisal of the significance of the core, we must depend upon the experts. A correct decision in this case may well hang upon their testimony

and its credibility because what these observers knew or should have known between November 12, 1963 and April 9, 1964 is basic to a determination of what, if anything, should have been disclosed or whether it was "material."

For the defendants, Dean Forrester, Dean of the College of Mines of the University of Arizona and Director of the Arizona Bureau of Mines, said that "one hole is evidence of what you encounter only in that hole" and that even after K-55-3 was drilled in April 1964, it was "much more likely that the materials exposed in those two holes will extend for, let's say, two feet outside the limits of the hole than it is likely that it will extend 25 feet or that it will extend 50 feet."

Dr. Park, former Dean of the School of Earth Sciences at Stanford, admitted that K-55-1 was "an interesting one, a good one" but that there was not "any evidence at all for any discussion of extent, from one drill hole." Dr. Lacy, head of the mining department of the University of Arizona, was of the opinion that "There is no basis for making any sort of prediction out from the hole."

Wiles, a consulting mining engineer, conceded that K-55-1 was a remarkable drill hole but that he could not estimate therefrom the probabilities of finding a commercially mineable body of ore, adding that he had had "the misfortune of having found a very attractive first hole and after drilling 52 around it got no more ore." Walkey, the manager of the Kamkotia, a mine some 12 miles distant from the Timmins property, testified that the geological composition of the Kamkotia and TGS areas was similar but that he could neither estimate nor say the chances were good of proving a substantial body of ore as a result of K-55-1.

Even the Commission's experts, Adelstein and Pennebaker, would not estimate what ore, if any, might lie beyond the 1⅛ inch core.

Adelstein:

"I think assay value given for a drill hole, standing by itself without surrounding information, cannot be interpreted by itself as to what it really means."

Pennebaker:

Q. You certainly couldn't compute any tonnage from that single hole, could you? A. No, sir.

Q. Nor could you compute any grade of ore beyond what was in the core itself? A. You are confined to what is in the core, sir.

[This witness did say that it was "inconceivable to expect the ore would quit immediately outside the drill hole, but you have no way of measuring how far it is going to go except the favorable implication of the anomaly."]

From this testimony, the trial court found:

"However, all the experts agreed that one drill core does not establish an ore body, much less a mine. Defendants' experts unanimously concluded that there is no way even to estimate the probabilities that one drill core will lead to the discovery of an ore body." 238 F. Supp. at 282.

Despite the experts' virtually uncontradicted testimony, despite Rule 52 a) and despite the Supreme Court's statement of the law, the majority choose to reject the trial court's findings as to the results of the first drill core, K-55-1, and to substitute their own expertise in the mining engineering field by holding that "knowledge of the possibility which surely was more than marginal of the existence of a mine of the vast magnitude indicated by the remarkably rich drill core located rather close to the surface (sug-

gesting mineability by the less expensive open-pit method) within the confines of a large anomaly (suggesting an extensive region of mineralization) might well have affected the price of TGS stock and would certainly have been an important fact to a reasonable, if speculative, investor in deciding whether he should buy, sell or hold."

Indeed, any such conclusions from a first drill core, if so announced by TGS, would undoubtedly have had a substantial effect on the market price of TGS stock and would have immediately brought forth both the wrath of, and injunction papers from, the Commission charging TGS with issuing false, misleading and unsupported statements to boost the price of the stock.

Factually, the premise posed by the majority is "clearly erroneous." There was no knowledge of the existence of a "mine." Even to the majority in their self-assumed fact-finding role, the "mine" was only a more than marginal "possibility." The testimony was unanimous that no estimate of "magnitude" could be made. The "large anomaly" did not suggest "an extensive region of mineralization" and furthermore TGS did not own or control it in any event. Its area was then limited to its one-quarter segment.

The majority read the record as conclusively establishing "that knowledge of the results of the discovery hole, K-55-1, would have been important to a reasonable investor and might have affected the price of the stock." But disclosure of the "results", namely, preliminary visual inspection of the contents, would have violated the Commission's own rules and standards. The Commission has specifically declared (Sch. I, Form 1-A, Reg. A offerings under the 1933 Act):

> "No claim shall be made as to the existence of a body of ore unless it has been sufficiently tested to be prop-

> erly classified as 'proven' or 'probable' ore, as defined below. If the work done has not established the existence of proven or probable ore, a statement shall be made that no body of commercial ore is known to exist on the property."

Item 8(A)(b), 1 CCH Fed. Sec. L. Rep. ¶7327.

The Commission has carefully defined the scope of sampling required to justify even estimates, as follows:

> "The term 'proven ore' means a body of ore so extensively sampled that the risk of failure in continuity of the ore in such body is reduced to a minimum. The term 'probable ore' means ore as to which the risk of failure in continuity is greater than for proven ore, but as to which there is sufficient warrant for assuming continuity of the ore."

Id., Item 8A(c), 1 CCH Fed. Sec. L. Rep. ¶7327.

Thus under the Commission's own standards, TGS, if it revealed any information during the November 1963-April 1964 period, would have had to announce to the public in substance "TGS has drilled a 1⅛" core on a one-quarter section owned by it in Timmins, Canada. Although the core appears to have excellent mineral content 'no body of commercial ore is known to exist on the property.'" Contrast such a statement with the April 12, 1964 release so criticized by the Commission. Further contrast it with a hypothetical November 1963 press release implicitly suggested by the majority "TGS as a result of drilling on its property in Canada has knowledge of the more than marginal possibility of a mine of magnitude over an extensive region of remarkably rich mineralization."—a statement which under the circumstances and then known facts would have been the height of recklessness.

In fact, the Commission itself indulges in the very speculation it condemns for, after conceding that "the trial court correctly stated that one drill hole does not establish the existence of a commercially mineable mineral deposit," it straightway contends that the information which arose after the drilling of this first and only (for 4½ months) drill hole revealed such "chances of imminent success, viewed in the light of the magnitude of the potential economic benefit to Texas Gulf" as to require disclosure by insiders desiring to buy TGS securities.

The Commission's position, consistent with its rules and regulations to protect the public from premature announcements which might well arouse speculative fervor are well expressed in its argument before this Court in its brief on appeal in *Securities and Exchange Commission* v. *Great American Industries, Inc., et al.,* 259 F. Supp. 99, S. D. N. Y., 1966, where it said:

> "Neither the Commission, the sellers, nor anyone else knew or could establish the value of the [mining] properties since they had not been explored except in a very preliminary way. No one can prove the value of a largely unexplored mining prospect" (p. 19).

The conservative (and in my opinion proper) approach of the Commission in *Great American* is reflected in its statement that "The ore content of a property is never 'known' until the ore has been completely removed and the minerals separated." This is probably an overstatement because by the time of the TGS April 16, 1964 press release, exploration had advanced to a point where an estimate of the extent of the tonnage might have been rather accurately made. The Commission in that case also stated two truisms (1) that "it is extremely important that all facts relevant

to an estimate of the value of such property be disclosed," and (2) that "the judgment of the 'value' of this property is dependent upon the results of exploratory work • • • •" (*Great American* brief, pp. 22, 23).

On November 12, 1963 drilling of K-55-1 was terminated at 655 feet. The core of the drill hole contained relatively high percentages of copper and zinc and some silver, although the percentages at any given point fluctuated widely. This result undoubtedly "excited the interest" of the TGS exploration team. TGS decided to acquire the surrounding plots in the Kidd 55 area to enable it fully to investigate the anomaly. The attempt to acquire the adjoining properties at reasonable prices (ultimately $52,500) and the strictures on secrecy are customary in the mining industry, especially when dealing with land of a highly uncertain value. After all, TGS had prior experience in exploration where initially promising situations turned out to be "duds." For example, the company had spent some $7,000,000 to purchase an underwater dome off the coast of Texas and an additional $1,000,000 to drill 21 holes before concluding that there was not enough sulphur in the dome to be of commercial interest.

However, until drilling was resumed, nothing further was learned about the ore content of the property other than as revealed in November and December 1963 from the analysis of K-55-1. The trial court's finding as to this fact is unassailable:

> "The most that can be said of the individual defendants' knowledge after the drilling of K-55-1 is that they had 'hopes, perhaps with some reason,' that it would lead to a mine. *James Blackstone Mem. Lib. Ass'n* v. *Gulf, M. & O. R. Co.*, 264 F. 2d 445, 450 (7th Cir. 1959). The results of K-55-1 were too 'remote'

> when considered in light of the size of TGS, the scope of its activities, and the number of its outstanding shares, to have had any significant impact on the market, i.e., to be deemed material." 258 F. Supp. at 283.

This conclusion is amply supported by the record. Kidd 55 was only one of several thousand anomalies (areas where there is unusual variation in the electrical conductivity of rocks) that TGS detected in its aerial exploration of the Canadian shield. Several hundred of these were considered worthy of further study and options on the land around them were acquired. The District Court found that "TGS had previously drilled 65 equally promising anomalies, but most of them had revealed either barren pyrite or graphite, while a few had shown marginal mineral deposits in insufficient quantities to be commercially mined" (258 F. Supp. at 271).

Against this factual background, what position should have been taken by those few officers and employees of TGS after they knew of the core, K-55-1, and the reports thereon made after visual inspection and analysis? There were several choices. Knowing that the nature and extent of this prospect could not be measured until further exploration was conducted and that further exploration had to await additional land acquisition they could have made no announcement as was the case here.

Turning now to the hypothesis of disclosure: As previously stated, any announcement of the discovery of a remarkable mine would have been both false and misleading. The Commission, however, impliedly suggests for affirmative answer the question: "Whether the chances of imminent success, viewed in the light of the magnitude of the potential economic benefit to Texas Gulf" did not require disclosure by insiders of the status of the drilling [then

only the first hole, K-55-1]? In the field of speculation, it would be interesting to know the position the Commission would have taken if TGS had announced that K-55-1 was "one of the most impressive drill holes completed in modern times" and that it "is just beyond your wildest imagination" (SEC Brief, p. 25). It requires no imagination to venture that such announcements might well have had the "wildest" impact on the market price of TGS stock.

Assuming the majority's and the Commission's full disclosure theory, would the facts as then developed have given the buying or selling public the so-called advantages possessed by the insiders? TGS could have announced by November 15, 1963 that it had completed a first exploratory hole, the core of which by visual examination revealed over a length of 599 of 655 feet drilled, an average copper content of 1.15%, zinc 8.64% or, had TGS waited until mid-December, by chemical analysis 1.18% copper, 8.26% zinc and 2.94% ounces of silver per ton; that TGS would try to acquire the other three-quarters of the segment unless the announcement boosted prices to unwarranted heights; that if the property could be acquired further exploratory holes would be drilled to ascertain the nature and extent, if any, of the ore body; that reports of developments would be made from time to time but that the SEC had indicated that TGS should advise its stockholders and the public that there was no proof as yet that a body of commercial ore exists on the property. Such an announcement would, of course, have been of no value to anyone except possibly a few graduates of Institutes of Technology and they, as the expert witnesses here, would have recognized that one drill hole does not reveal a commercially profitable mine.

The final question to be answered is: were these officers and employees disqualified as the result of possessing information gleaned by the first drill core from purchasing

TGS stock? The number of possibilities for Congressional legislation and Commission rulings are legion. They extend over a gamut between definite extremes. At one extreme is a rule that no officer or employee or any member of their families shall own stock of the company for which they work or purchase stock if he possesses "material" inside information. This assumption raises the question of what is material and who is to make such a determination. Materiality must depend upon the facts and their resolution is for the fact-finder, court or jury. The majority state that the K-55-1 drilling results were material because they "might well have affected the price of TGS stock." But such a statement could be made of almost any fact related to TGS. If a labor strike had kept its plants idle for months, encouraging news of a possible settlement hoped for by the TGS labor negotiators might cause the negotiators to buy. Their belief that the strike would be protracted might cause them to sell. Either announcement might well have affected the market and would to those who bought or sold have seemed misleading and deceptive if the anticipated event did not come to pass. Yet the requirement of hourly bulletins to the press from the conference room would not be compatible with common sense. Scores of day by day intra-company situations come to mind which in the individual opinions of company officers or employees might well affect the price of TGS stock, each individual reacting according to his own judgment. However, companies listed on a national exchange can scarcely broadcast to the nation on a daily basis their hopes and/or expectations from the developments in, for example, their research departments. An even more striking illustration would be found within the structure of a large pharmaceutical company where discoveries of panaceas to cure human disease occupies the workdays of thousands of scien-

tists. Premature announcements of important discoveries would be branded as false and misleading if unfulfilled and all stock purchases made during the course of the research, if ultimately successful would be said to have been made with the advantage of inside information. At the other extreme is an equally easy-to-resolve *Cady, Roberts*[1] situation where a definite fact (the reduction of the dividend) was known by an insider, who participated in the meeting where the decision had already been made, whose knowledge of the probable reaction of the market to such an announcement, namely, a substantial sell-off, caused him to leave the meeting ahead of everyone else and before the potential buyers learned of the bad news to foist his selling orders on the market and his stock on uninformed purchasers. Between these extremes there should be a rule of reason.

Faced with this problem, the trial court selected a period from November 12, 1963 (the first information) to some date after drilling was resumed when it might reasonably be said that a body of commercially mineable ore *might* exist. The trial court, accepting the Commission's experts' version, fixed 7:00 p.m. on April 9, 1964 as the time when TGS had material information which "if disclosed, would have had a substantial impact on the market price of TGS stock" but also found that "the drilling results up to 7:00 p.m. on April 9th did not provide such material information." These findings are clearly supported by the proof upon which the court relied.

Practically all TGS stock in question here was purchased between November 12, 1963 and April 8, 1964. What were the motives behind each of the purchases? Obviously, a subjective approach presents difficulties. A myriad of reasons would be given—hope that a commercially profitable

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1 *In re Cady, Roberts & Co.*, 40 SEC 907 (1961).

mine would be found if further exploration proved the ore to be as promising as the core of K-55-1 (November 12, 1963); the development of a phosphate project and potash mine (November 15, 1963); the prediction of security analysts that there would be a turnabout in the price of sulphur stocks; the acquisition of Canadian oil properties (December 16, 1963); the new high level of free world sulphur use and output (December 30, 1963); the launching of the world's largest liquid sulphur tanker (December 30, 1963); the entry into service of a large liquid sulphur tanker for domestic shipments (January 18, 1964); the sulphur expansion program in Canada (February 8, 1964); the new four-year high in sales reached in 1963 (February 20, 1964); and the $2 per ton price increase for sulphur (April 1, 1964).

There can be little doubt but that those familiar with the results of K-55-1 were influenced thereby in making their purchases. The conclusion of the majority is based primarily on this assumption. They call it "a major factor in determining whether the K-55-1 discovery was a material fact" and say that this "virtually compels the inference that the insiders were influenced by the drilling results." To them, completely disregarding the trial court's findings and substituting themselves as a jury, these purchases are "the only truly objective evidence of the materiality of the K-55-1 discovery." In so holding, they confuse the inducing motive of the individual purchaser with knowledge of material facts which ought to be revealed to the public at large. The inconsistency of the majority's position is immediately apparent. Those who purchased were apparently willing on the basis of the inconclusive first hole and other information to risk a certain amount of their funds in TGS stock, hopeful that

future developments would be favorable. Their motive for purchase does not establish the materiality of the facts which influenced them. However, the importance of this case to the corporate and financial community centers around the news release, its timing and its content. It is unfortunate that the atmosphere surrounding this important issue has been so colored and in the collective mind of the majority so contaminated by the comparatively insignificant stock purchase issue.

The resolution, if such be possible, of the many problems presented in this field should be by rule, as definite as possible, formulated in the light of reality and not retroactive in effect as here. I understand that the Commission has conducted, or is conducting, hearings to enable it to learn the views of the many persons and corporations affected. Presumably the Commission will make recommendations to the Congress to give that body an opportunity to accept or reject after thoughtful debate such proposals as may be made. The companies, the securities of which are listed on exchanges, their employees and investing public alike should have some knowledge of the rules which will govern their actions. They should not be forced, despite an exercise of the best judgment, to act at their peril or refrain *in terrorem* from acting. As to a waiting period after the information regarded as "material" has been disclosed, any such time period should be specifically fixed by Congressional or Commission rule not retroactive in application. There is no proof here that the purchases of the defendants, even if motivated by hopes not then solidly grounded, raised or lowered the market or were manipulative, misleading, deceptive or were accomplished by false or fraudulent devices. The trial court after hearing and seeing the witnesses has resolved these factual issues and in my opinion its decision should be sustained.

Stock Options

On February 20, 1964 the stock option committee, which was not informed of the developments at Kidd 55, granted options to Stephens, Fogarty, Mollison, Holyk, Kline and a number of other top officers of TGS. Since only K-55-1 had been drilled at that point, the District Court correctly held that there was no duty of disclosure on the part of those receiving the options. Assuming *arguendo* that the information was material, those not in top management have no duty to disclose to the directors information already reported to their own superiors since they may reasonably assume that the information has been conveyed to the directors on the stock option committee. The District Court held that Holyk, Mollison and Kline were not in top management and that Kline was ignorant of the details of the drilling results, so as to them no violation of 10b-5 had been made out. The majority disagree as to Kline, placing him in top management along with Stephens and Fogarty, and holding that he had sufficient knowledge that his nondisclosure violated Rule 10b-5. Since the majority admit that Kline "knew only that a hole containing favorable bodies of copper and zinc ore had been drilled in Timmins," it seems clear that he did not possess material information that had to be disclosed. That being the case, I find it unnecessary to decide whether or not Kline was in "top management."

As to Stephens and Fogarty, the majority decision places insider recipients of stock options in a difficult dilemma. Under the majority's decision, an insider must perform the uncommon act of refusing such an option, promoting speculation as to the reasons therefor, or accept the option and face possible 10b-5 liability. The objective of protecting a corporation from selling securities to insiders at a

price below their true worth is fully served by requiring nondisclosing insiders to abstain, not from accepting the stock options, but merely from exercising them—an event likely to occur after the inside information has become public. In any case, the failure to exercise an option is less likely to suggest that the insider possessed material information than the failure to accept such an option. Since the option granted to Kline had not been exercised prior to its ratification by the Texas Gulf directors on July 15, 1965, after full disclosure, there can be no 10b-5 violation as to him, and rescission of the option he received should not be ordered. As Stephens and Fogarty have surrendered the options and the corporation has canceled them, there has certainly been no violation of 10b-5 by them with respect to those options.

The April 12, 1964 Press Release

The majority suggest with, in my opinion, most remarkable business naivete that, instead of the April 12, 1964 press release which the trial court had found as a matter of fact had been issued in the exercise of "reasonable business judgment under the circumstances," in their 1968 judgment "it would have obviously been better to have specifically described the known drilling progress as of April 10th by stating the basic facts." They also suggest that "[s]uch an explicit disclosure would have permitted the investing public to evaluate the 'prospect' of a mine at Timmins without having to read between the lines to understand that preliminary indications were favorable—in itself an understatement." Had TGS followed this *ex post facto* directive, it first would have had to find some news medium capable of reaching the nation's potential investing public and willing to publish a mass of metallurgical reports disclosing

the "basic facts." Any such procedure would have invited the initial question on cross-examination of TGS officials: How could any such "explicit disclosure" have permitted the investing public to evaluate the prospect of a mine, without the necessity of transmitting it for expert opinion to some School of Mines? Of course there would be but one answer: It could not.

The facts as established between the date of the resumption of drilling and the drafting of the release are as follows:

On March 31, 1964 TGS moved four drill rigs onto the property, and by April 10th all were in operation. On Friday morning, April 10th, Mollison and Holyk visited the property and learned the results of the drilling up to that time. Mollison left for New York that evening, arriving on Saturday morning. Holyk left for New York Saturday morning and arrived that same day. Until Saturday morning TGS did not intend to issue a press release on the progress of the exploration.

Despite rumors in the Canadian press that TGS had made a major discovery, Lamont had advised Stephens "that TGS should take no action unless the rumors reached the New York press or until TGS had sufficient information available to issue an appropriate press release." 258 F. Supp. at 293. On Saturday morning, April 11th, both the New York Herald Tribune and the New York Times prominently reported a major ore discovery. In a front page article carrying the title "Canada's Copper Rush" the Herald Tribune stated "The biggest ore strike since gold was discovered more than 60 years ago in Canada has stampeded speculators to the snowbound old mining city of Timmins . . . ." The article also stated that the richness of the copper was so great that the core was flown out of the

country to be assayed and that four more drill rigs were scheduled to start working the following week. All of these statements were inaccurate and a matter of concern to Fogarty and Stephens.[2] Stephens advised Fogarty that TGS should issue a press release to clarify the rumors that Fogarty therefore contacted Mollison who had just returned from Timmins.

Mollison had been advised by Holyk as to the drilling results up to 7:00 p.m. on April 10th. On the basis of this information he, as an experienced mining engineer, did not feel that there was sufficient information to draw conclusions as to size and grade of ore, and he advised Fogarty accordingly.

The District Court held:

> "In seeking the advice of Mollison, the head of TGS's exploration group, in consulting with TGS's public relations firm, and in clearing the release with one of TGS's lawyers, Stephens and Fogarty exercised reasonable business judgment under the circumstances." 258 F. Supp. at 296.

The press release was drawn up with the aid of the above-mentioned persons on Saturday and Sunday morning, and was delivered to the press on Sunday for publication in the Monday papers. It stated in part:

> "Recent drilling on one ore property near Timmins has led to preliminary indications that more drilling

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2 The New York Stock Exchange Company Manual provides:

"Dealing with Rumors Affecting the Market: Occasions may also arise when rumors have been circulated which have no basis in fact or which require clarification or interpretation and which also result in unusual activity or price changes in a particular security. Under such circumstances, the most effective procedure is the quick and speedy denial of such rumors through a release to the public Press . . ."

would be required for proper evaluation of this prospect. The drilling done to date has not been conclusive, but the statements made by many outside quarters are unreliable and include information and figures that are not available to TGS.

"The work done to date has not been sufficient to reach definite conclusions and any statement as to size and grade of ore would be premature and possibly misleading. When we have progressed to the point where reasonable and logical conclusions can be made, TGS will issue a definite statement to its stockholders and to the public in order to clarify the Timmins project."

The majority offer suggestions for improving the press release, but, as their editorial skills and present appraisal of the then mining situation were not available when it was drafted, the relevant issue is whether the District Court was in error in determining that the release was accurate and not misleading.

By 7:00 p.m., April 10, the following data was available:

1. geologists' logs of visual estimate and chemical assay of the results of K-55-1,
2. preliminary estimates of 757 feet of K-55-3 and unrecorded visual estimates of 569 feet of K-55-6, both drilled on the same line as K-55-1 (2400 S),
3. unrecorded visual appraisals of 476 feet of K-55-4, drilled 200 feet to the south of K-55-1, and
4. unrecorded visual appraisals of only 97 feet of K-55-5, drilled 200 feet to the north of K-55-1.

The Commission's experts testified that because copper and zinc had been found in these five holes (although in vary-

ing percentages) it could reasonably be concluded that the mineralization was continuous between holes 400 feet apart and also 100 feet beyond in each direction and to a depth of 600 feet, one hundred feet below the deepest hole. However, the District Court found that:

> "TGS's experts were unanimously of the opinion that at 7:00 p.m. on April 10 the Kidd 55 segment was still a prospect and that no estimates as to proven or probable ore could be made. They all agreed that the April 12 press release accurately set forth the situation as it was known at the time. None thought that TGS could have estimated proven ore, and the Commission's expert, Pennebaker, agreed that this was a matter on which there could be differences of opinion. Defendants' experts testified that on the basis of the drilling to that time there was no assurance of continuity in the mineralized zone and that, without further drilling, the results of one hole could not be correlated with the results of others." 258 F. Supp. at 295.

The April 12 release therefore correctly described Kidd 55 as a "prospect." While that term is a word of art in the mining trade used to describe "a property where there is no assurance, from the information known, that a commercially mineable ore body exists" [Pennebaker], its technical definition is no different from the definition in common use. See Webster's New International Dictionary (2d ed. unabridged 1960). Nor is there any inconsistency between the release and the District Court finding that as of April 9, 1964 "there was real evidence that a body of commercially mineable ore *might* exist." 258 F. Supp. at 282 (emphasis added). The District Court characterized the press release as an accurate portrayal of the situation as it was known

at that time. The inference is therefore inescapable that the Court felt that a reasonable investor would not be misled by it. The Commission's whole argument appears to be that the release should have been more optimistic (if conclusions were to be used at all), and that it should have referred to Kidd 55 as having "proven" or "probable" ore. But such a press release would have been highly misleading since the information necessary to draw such conclusions was not available on April 10—according to the TGS witnesses whom the District Court chose to believe.

As evidence that the April 12 release was probably inaccurate, the majority point to the fact that only three days later TGS prepared the April 16 release which announced a major mineral discovery. However, this release was based on more information of significance than was available on April 10 at 7:00 p.m. Between April 12 and April 15 five additional holes had been drilled, K-55-5, 6, 7, 8 and 10 and by April 15 at 7:00 p.m. 5198 feet of core had been drilled compared with 2776 feet on April 10. Furthermore, the location of drilling holes is critical in determining continuity. Most of the footage drilled by April 10 had been in a single plane (2400 S), but by April 15 drilling had established mineralization in a number of additional planes. There is therefore no inconsistency in the statements made and the conclusions reached in the two releases.

The majority remand for a determination of the effect of the April 12 release on a reasonable investor because in its opinion "the effect of this release on the investing public was equivocal and less than abundant." The evidence of the actual effect of the release on investors was at best inconclusive. The Commission offered no proof that anyone was misled by the release—e.g. testimony tending to show that most investors thought the release meant that TGS had no hopes of making an ore discovery. Those

that had been advised by the broker Roche to purchase stock did not sell upon reading the April 12 release. Several brokers testified that they interpreted the release as affirmative and encouraging. The market opened at 30⅛ on the 13th (when the release became public) and closed at 30⅞—scarcely a sign of public pessimism. The next day the market closed at 30¼. The District Court correctly found that "the issuance of the release produced no unusual market action." 258 F. Supp. at 294. Nor did he find the release to be "gloomy." His statement was that: "While, in retrospect, the press release may appear gloomy or incomplete, this does not make it misleading or deceptive on the basis of the facts then known." 258 F. Supp. at 296. With the aid of hindsight the release may indeed seem gloomy, but that is because it is now known that a very substantial tonnage of ore exists. Hindsight, however, is not the test. Furthermore, even if some investors considered the release to be discouraging compared to the rumors afloat, if the facts and conclusions presented were accurate (as they were) and if they were not presented in a manner that would mislead a reasonable investor (which they were not) then there can be no violation of 10b-5.

The District Court aptly pointed out that in quelling the rumors TGS had to proceed with caution:

> "If they said too much, they would have been open to criticism and possible liability if it turned out that TGS had not discovered a commercial mine. If they said too little and later announced a mine, they subjected themselves to the charge that their press release was misleading or deceptive—and, indeed, this is what has happened." 258 F. Supp. at 296.

While it thus might have been "safer" for TGS to have issued a sheaf of drilling results and mineral analyses

(which the press would probably have declined to print), "they would have [thereby] encouraged the rumor mill which they were seeking to allay." *(Ibid.)* Stephens and Fogarty decided that the best course was to give their evaluation of the situation—a reasonable business judgment that should not incur 10b-5 liability unless their evaluation was either false or misleading. The experts which the trial court credited were of the opinion that Kidd 55 was accurately portrayed as a prospect which required further exploration. The trial court found that the release was not "misleading or deceptive on the basis of the facts then known," and the majority state that from the record they cannot "definitively conclude that it was deceptive or misleading to the reasonable investor." It would therefore appear that the Commission has failed in its burden of proof, unless it can be said that TGS was negligent in not obtaining later data from Timmins before issuing the release.[3]

Of necessity the April 12 press release had to be issued on the basis of the drilling results through 7:00 p.m., April 10, and it seems clear that the trial court determined that it would not be reasonable to charge TGS with knowledge of later information. While additional drilling was done on Saturday and Sunday, April 11 and 12, the cores had not been seen by the geologists advising management, and there was no way of communicating with the drill site even if someone had been available there to give a reliable appraisal. Mollison and Holyk were in New York for the weekend, and there was no telephone at the site—the only way to communicate with the site was to go there. The decision to issue a press release was not made until Satur-

3 Of course, even if TGS were negligent in not obtaining later data, a determination must still be made that the press release was misleading in light of this later information.

day, at which point Fogarty testified it "would just be very difficult for us to try to find anyone in Timmins." The statement was released Sunday afternoon and Mollison and Holyk were asked "to return to Timmins as promptly as possible and to move things along." It therefore cannot be said that TGS was negligent in not obtaining more current data, and it is certainly not negligent simply because it decided to issue the statement when it did. A remand on this point is therefore not justified.

The "in connection with" Clause Precludes the Imposition of §10(b) Liability on TGS.

In any event, the Commission still has the problem of showing that the other requirement of the statute and rule is met, namely that the release was issued "in connection with" a securities transaction on the part of TGS. This requirement is explicit in §10(b) of the Act (15 U. S. C. §78j) which provides:

> It shall be unlawful for any person . . .
>
> (b) To use, or employ, *in connection with the purchase or sale of any security* registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Pursuant to this authority the Commission in 1942 promulgated Rule 10b-5 (17 C. F. R. §240.10b-5) which states:

> Employment of Manipulative and Deceptive Devices
>
> It shall be unlawful for any person . . .
>
> (a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, *in connection with the purchase or sale of any security.*

In determining whether the requisite "connection" to a securities transaction was present in this case, the District Court found:

> "From the foregoing, it is apparent that the purpose of the April 12 press release was an attempt to meet the rumors which were circulating with respect to the Kidd 55 segment. There is no evidence that TGS derived any direct benefit from the issuance of the press release or that any of the defendants who participated in its preparation used it to their personal advantage. The issuance of the release produced no unusual market action. In the absence of a showing that the purpose of the April 12 press release was to affect the market price of TGS stock to the advantage of TGS or its insiders, the issuance of the press release did not constitute a violation of Section 10(b) or Rule 10b-5 since it was not issued 'in connection with the purchase or sale of any security.'" 258 F. Supp. at 294.

The District Court held that if TGS or its insiders had purchased TGS stock after issuing the allegedly misleading press release, the inference could be drawn that it was issued to reduce the price of the stock to facilitate purchases at bargain prices. Such a deceptive or manipulative

practice would be prohibited by 10(b) and Rule 10b-5. See *Gann* v. *BernzOmatic*, 262 F. Supp. 301 (SDNY 1966); *Cochran* v. *Channing Corp.*, 211 F. Supp. 239 (SDNY 1962). Moreover, noting that the "in connection" clause has been broadly construed, the District Court did not require that stock purchases by TGS or insiders be shown. Instead, the court held that "the issuance of a false and misleading press release may constitute a violation of Section 10(b) and Rule 10b-5 if its purpose is to affect the market price of the company's stock to the advantage of the company or its insiders. *Freed* v. *Szabo Food Serv., Inc.*, CCH Fed. Sec. L. Rep. ¶91,317 (N. D. Ill. 1964)." 258 F. Supp. at 293. Thus, even if TGS or its insiders had not engaged in securities transactions, if there were evidence from which it could be inferred that the press release was intentionally issued to depress the price of the stock as part of some fraudulent scheme, a 10b-5 violation would have been stated.[4] But in this case the only purpose of the press release was to quell the extravagant rumors circulating about the Canadian exploration project. No facts whatsoever were adduced which would have justified a finding that the release was issued for a fraudulent or manipulative purpose. To hold that such a statement incurs 10b-5 liability is contrary to the intent of Congress in passing §10(b) and settled judicial construction. Furthermore, such a holding might well have the unfortunate result of deterring the dissemination of corporate news despite the strong policy underlying all securities legislation of encouraging disclosure of information useful to present and potential investors. If press releases have to read like prospectuses to guard against possible 10b-5 liability, it is safe to predict that they will quickly fall out of favor with corporate management.

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4 Whether the release had any such effect would, of course, be irrelevant.

The Commission advances the argument (successful with the majority) that the "in connection" requirement is satisfied by the mere fact that the public is purchasing and selling securities on the open market. Thus any statement issued by a publicly listed company is made "in connection" with the purchase or sale of securities. The majority approve of this interpretation because "the investing public may be injured as much by one's misleading statement containing inaccuracies caused by negligence as by a misleading statement published intentionally to further a wrongful purpose." However, the fact remains that §10(b) of the Securities Exchange Act was not passed to protect investors from the former type of injury, but leaves liability for such misrepresentation up to state law, which is well equipped to handle any such situation. See, e.g., Note, Accountant's Liabilities for False and Misleading Statements, 67 Colum. L. Rev. 1437 (1967). Section 10(b) was certainly not intended to be a mandate to the Commission to erect a comprehensive regulatory system policing all corporate publicity, as the majority now contend. The legislative history clearly reveals that the statute was passed to prohibit deceptive and manipulative devices used in connection with securities transactions, and that the "connection" between the complained of conduct and the securities transactions must be a closer one than the majority now sanctions. See S. Rep. No. 792, 73rd Cong., 2d Sess. (1934); H. R. Rep. No. 1383, 73rd Cong., 2d Sess. (1934); S. Rep. No. 1455, 73rd Cong., 2d Sess. (1934); Comment, 74 Yale L. J. 658, 681-82 (1965).

The broad congressional purpose in passing the Securities Exchange Act of 1934 is set forth by Thomas G. Corcoran, one of the draftsmen of the bill that became the 1934 Act. He stated at a 1934 House hearing that "this bill has

at bottom five ideas in it, and all 36 pages tie in around the five ideas." According to Corcoran these five ideas were (1) control on the amount of credit, (2) control of manipulations, (3) control of insider trading [§16(b)], (4) elimination of abuses in the market machinery, and (5) the establishment of the Securities Exchange Commission to administer the Act. As to manipulation, he testified that:

> "As I will point out later, there are only a very few real battlegrounds in this act. Manipulation is not one of them. The provisions of this bill, as to manipulations upon stock exchanges, are agreed to practically everywhere. . . . Matched orders, washed sales, pools, options —all of the rest of them are out. So, control of manipulative practices is really not something your committee has to thrash out around this table." [5]

It is therefore not surprising that there is little discussion in the legislative history as to the meaning of the language in the anti-manipulation provisions. It was obviously thought that sections outlawing devices that had been shown at great length to be deleterious did not require any lengthy explication. This is unfortunate because it has resulted in §10(b) being given a construction and significance which, in my opinion, Congress did not foresee and did not intend.

This conclusion is fortified by the provisions of the Act dealing with manipulation since the more specific prohibitions make it clear what evils Congress intended to eradicate by §10(b). Section 9, 15 U. S. C. §78i provides that it shall be unlawful for any broker, dealer or other person to create a false or misleading appearance of activity in the

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5 Hearings before the House Committee on Interstate and Foreign Commerce on H. R. 7852 and H. R. 8720, 73rd Cong., 2d Sess. (1934).

market for a stock or to attempt to affect the price of a stock by certain specific manipulative devices.

Section 10(a), 15 U. S. C. §78j provides:

> Manipulative and Deceptive Devices
>
> It shall be unlawful for any person . . .
>
> (a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Read in context it seems clear that §10(b) was only meant to be a supplement to the specific prohibitions contained in §9 and §10(a). Commenting on the section that became §10(b), Corcoran stated:

> "Subsection [b] says, 'Thou shalt not devise any other cunning devices.' . . . Of course subsection [b] is a catch-all clause to prevent manipulative devices. I do not think there is any objection to that kind of a clause. The Commission should have the authority to deal with new manipulative devices."

Since the manipulative devices outlawed by §9 all involve fraudulent activities integrally related to securities transactions, the conclusion necessarily follows that the "other cunning devices" sought to be prohibited by §10(b) and Rule 10b-5 are those which also involve securities transactions as an integral part of the fraud. The statute as enacted requires that the fraudulent scheme be "in connection with the purchase or sale of any security." The

expression "in connection" is used elsewhere in the Act, including §9(b), as a shorthand method of indicating that the activity sought to be made illegal is that having a direct relation to securities transactions. The majority read the phrase as merely requiring that the allegedly misleading statement be issued by a publicly traded corporation. They argue that the "connection" that has to exist between a corporate statement and a security transaction is supplied by the theoretical argument that every "material" corporate statement presumably affects the market price of the issuer's securities. In my opinion such a broad interpretation of the statute is unwarranted as a matter of statutory construction and unwise as a matter of policy.

Congress has made it clear in the other antifraud provisions of general application that its concern was not with allegedly misleading corporate publicity but rather with purposeful schemes to deceive and defraud the public by means of manipulative and deceptive devices which directly involve purchases or sales of securities. Thus §12(a), 15 U. S. C. §77*l* of the 1933 Act provides that any person who "offers or sells a security" by means of a prospectus or oral communication which includes a misstatement or omission of a material fact shall be civilly liable. Similarly §17(a) of the 1933 Act, 15 U. S. C. §77q(a), provides that it "shall be unlawful for any person in the offer or sale of any securities" to engage in fraudulent activity.

A further insight into the proper scope of 10b-5 can be gained by examining §17(a), 15 U. S. C. §77g(a) which is almost word for word the same except for the explicit requirement that any alleged fraud be associated with "the offer or sale of . . . securities." The only difference of substance between §17(a) and Rule 10b-5 is that the latter applies to purchasers as well as sellers. *Ellis* v. *Carter*,

291 F. 2d 270, 272-274 (9th Cir. 1961); SEC Sec. Exch. Act Rel. No. 3230 (May 21, 1942) ("The new rule closes a loophole in the protection against fraud administered by the Commission by prohibiting individuals or companies from buying securities if they engage in fraud in their purchase."); Milton Cohen, "Truth in Securities Revisited," 79 Harv. L. Rev. 1340, 1364 (1966).

Finally, §15(c)(1), (2), 15 U. S. C. §78o(c)(1), (2) provides that no broker or dealer shall (1) induce the purchase or sale of any security by means of any manipulative, deceptive or other fraudulent contrivance or (2) attempt to induce the purchase or sale of any security "in connection with which such broker or dealer engages in any fraudulent, deceptive, or manipulative act or practice . . . ."

The majority argue that when compared with the above provisions the slight change of wording in §10(b)—the insertion of the phrase "in connection with . . . "—indicates that Congress intended a revolutionary change in the whole thrust of the securities laws. That is too slim a basis to support a judicial excursion over such uncharted seas. It is most doubtful that Congress intended such a result, and the merits of such a change are so unexplored that Congress should certainly be consulted before making it.

The majority support their action in part by a long quotation from H. R. Rep. No. 1383. It should be noted that the discussion at that point of the report is not addressed to §10(b) but to the reporting and disclosure provisions of Securities Exchange Act of 1934, specifically §§12-14, 16. Section 12 of the Act, 15 U. S. C. §78*l*, requires the registration of securities traded on a stock exchange and of certain other widely held securities. Detailed information similar to that required by the 1933 Act has to be filed with the Commission for such registered securities, and this infor-

mation is required by §13, 15 U. S. C. §78m, to be kept "reasonably current" by periodic and other reports filed with the Commission and the stock exchanges. In addition §16(a), 15 U. S. C. §78p(a), requires certain officers, directors and major shareholders to file reports with the Commission and the stock exchanges as to their initial holdings of stock and subsequent changes. Finally, pursuant to §14, 15 U. S. C. §78n, the Commission has promulgated proxy rules setting forth information that must be sent to shareholders prior to their annual or other meetings. See Schedules 14A-14C, 17 C. F. R. §240.14a-101–103.

To encourage compliance with these disclosure and reporting requirements, Congress enacted civil (§18, 15 U. S. C. §78r) and criminal (§32, 15 U. S. C. §78ff) provisions. A close reading of §18 will demonstrate that a plaintiff proceeding under that section (as opposed to §10(b)) does not have to show that the misleading statement was issued by a person [or corporation] who engaged or participated in a securities transaction or even that the misstatement was intended to influence securities transactions as part of some fraudulent scheme. Therefore, the statements in the legislative history applicable to the reporting and disclosure provisions have no bearing on the correct interpretation of §10(b). That section was not meant to be an auxiliary disclosure device or a provision to punish those who issue inaccurate statements in newspapers or documents filed with the Commission *unless* they are fraudulent acts integrally connected with securities transactions. If there is no such connection, investors are relegated to §18 or state law to recover their losses and the Commission must use its other remedies, discussed *infra*.

In discussing Rule 10b-5 Cohen expressed concern which, as a result of the majority opinion, seems to have been well

founded, that Rule 10b-5 would be given an "unwarranted" extension. In "Truth in Securities Revisited," *op. cit. supra,* at 1366, he said:

> "Nor is it clear that Rule 10b-5 will not be read as providing an alternative remedy (alternative to the considerably more limited express remedy of section 18) for false or misleading statements in filing under sections 12 and 13. One might regard these as surprising and even unwarranted extensions of Congress's terse proscription of 'any manipulative or deceptive device or contrivance' in section 10(b) and yet not care to predict confidently that the momentum of decisions will not carry this far."
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> " . . . I firmly believe that whatever inadequacy is found in §18, as the basic civil liability provision applicable to the continuous disclosure system, ought to be taken care of by direct amendment of the section itself, not by resorting to the broader, vaguer, but (in my view) otherwise directed provisions of Rule 10b-5. I believe that the problem of misrepresentation in a registrant's (issuer's) required filings is quite distinct from the problem of fraud or misrepresentation by a purchaser or seller of a security (even though the two areas sometimes overlap), and that more mischief than good is likely to come from confusing them or treating them as interchangeable."
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> (Cohen, *op. cit. supra* at 1370, n. 89)

The majority opinion must also be considered in light of its overall impact before a decision can be reached as to its advisability (assuming that the power to interpret §10(b) is as unlimited as the majority apparently believe).

It should be realized that the construction given 10b-5 will turn it into a comprehensive regulatory provision applicable to all corporate and individual statements, but without any of the detailed standards necessary to implement such a program. The Commission is presently arguing that 10b-5 is applicable to all corporate statements disseminated to the public or filed with the Commission. See *S. E. C.* v. *Great American Industries, Inc.*, 259 F. Supp. 99 (S. D. N. Y. 1966), appeal pending; *Heit* v. *Weitzen*, 260 F. Supp. 598 (S. D. N. Y. 1966), *Howard* v. *Levine*, 262 F. Supp. 643 (S. D. N. Y. 1965), consolidated appeal pending sub nom. *Heit* v. *Weitzen* (*amicus curiae*). The majority opinion appears to approve of the Commission's position without reservation.

The Commission's arsenal of weapons for fighting misleading statements has certainly not been shown to be insufficient for it to carry out the tasks that Congress assigned to it. Rule 10b-5 remains a potent method of proceeding against fraudulent schemes which involve securities transactions for both the Commission and private investors. The Commission can also obtain injunctions to enforce compliance with the disclosure and other provisions of the Securities Exchange Act (§21, 15 U. S. C. §78u), and stiff criminal penalties are provided for failure to comply with the statute or rules promulgated thereunder (§32, U. S. C. §78ff). The Commission can suspend trading for successive periods of 10 days in any security which it feels is being affected by misleading press releases (§§15(c)(5), 19(a)(4), 15 U. S. C. §§78o(c)(5), 78s(a)(4)). For an example of the effective use of this latter power see SEC Sec. Exch. Act Rel. No. 7741 (Nov. 4, 1965) relating to suspension in trading of Belock Instrument Corporation, a defendant in *Heit* v. *Weitzen, supra.* Finally, when faced

with the repeated issuance of misleading press releases, the courts can without more proof draw the inference that they were purposefully distributed to affect the price of the issuer's securities, justifying injunctive relief under 10b-5 and possibly other remedies. See *SEC* v. *Electrogen Industries, Inc.*, 68 Civ. 23 (EDNY, Feb. 26, 1968). In any event if the Commission feels that its arsenal should be augmented, Congress not the courts is the proper forum for its arguments.

Other Judicial Interpretation

The construction given the "in connection" clause by the District Court has been followed in the many cases that have considered the point. See *SEC* v. *North American Research & Development Corp.*, 1968 CCH Fed. Sec. L. Rep. ¶92,149 (SDNY Feb. 8, 1968); *Puharich* v. *Borders Electronics Co., Inc.*, 1968 Fed. Sec. L. Rep. ¶92,141 (SDNY Jan. 24, 1968); *Howard* v. *Levine*, 262 F. Supp. 643 (SDNY 1965), appeal pending; *Gann* v. *BernzOmatic*, 262 F. Supp. 301 (SDNY 1966) (dictum); *Heit* v. *Weitzen*, 260 F. Supp. 598 (SDNY 1966), appeal pending.

It is of course true, as the Commission points out, that the "in connection" clause has been given a broad construction by the courts in line with the remedial nature of securities legislation (see *SEC* v. *Capital Gains Bureau*, 375 U. S. 180, 195 (1965); cf. *Tcherepnin* v. *Knight*, 389 U. S. 332, 336 (1967)), but no case supports the Commission's position that it is in effect meaningless. The cases to date have involved defendants who if not actually purchasing or selling securities at least participated in a direct manner in a securities fraud.[6] Thus one who conspires with or aids and abets another in the fraudulent purchase or sale

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6 In two cases, on motions to dismiss, two courts have permitted 10b-5 actions to continue where defendants were not alleged to be intimately

of securities may have the needed connection. See *Pettit* v. *American Stock Exchange*, 217 F. Supp. 21 (SDNY 1963) (Defendant Exchange and its officers allegedly aided and abetted an illegal distribution of stock by its failure to take necessary disciplinary actions against abusive conduct and practices of its employees of which they knew or should have known. Held: sufficient allegation of fraud under 10b-5); *Brennan* v. *Midwestern United Life Ins. Co.*, 259 F. Supp. 673 (N. D. Indiana 1966) (Defendant corporation allegedly aided and abetted an alleged violation of 10b-5 by its brokerage firm because of its failure to report the improper activities of said firm to the proper authorities. Held: cause of action stated under 10b-5).

Similarly, corporate officers or directors may be liable for causing their corporation to engage in securities transactions. See *Ruckle* v. *Roto American Corp.*, 339 F. 2d 24 (2d Cir. 1964) (Corporation allegedly defrauded into issuing securities to its President through the failure or refusal of some of its directors fully to disclose to the remaining directors material facts concerning the transactions or the financial condition of the company); *Bredehoeft* v. *Cornell*, 260 F. Supp. 557 (D. Ore. 1966) (Plaintiff induced to sell his stock to the corporation for less than its true value because the defendants, stockholders and directors of the company fraudulently concealed material facts); *New Park Mining Co.* v. *Cranmer*, 225 F. Supp. 261 (SDNY 1963) (Defendants caused plaintiff corporations, of which they were officers, to issue stock for property which was worth much less than the stock); cf. *H. L. Green Co.* v. *Childree*,

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connected with a purchase or sale of securities. *Miller* v. *Bargain City, U. S. A.*, 229 F. Supp. 33 (E. D. Pa. 1964); *Fischer* v. *Kletz*, 266 F. Supp. 180 (SDNY 1967). But in both cases the courts recognized that further factual and legal development was necessary for the proper resolution of the issue.

185 F. Supp. 95 (SDNY 1960) (Accountants allegedly induced corporation to go through with a merger (a securities transaction) by preparing false financial statements and making other misrepresentations).

A corporation may itself violate Rule 10b-5 if it engages in fraudulent activities in connection with a merger or other transaction involving securities. See *Freed* v. *Szabo Food Service, Inc.*, '61-'64 CCH Fed. Sec. L. Rep. ¶91,317 (N. D. Ill. 1964) (Corporation, as part of a campaign to boost the value of its stock to achieve stockholder approval of a merger, deliberately issued statements misrepresenting future combined earnings. The price went up and the shareholders were impressed with this indication of the opinion of the financial community as to the proposed merger. The plaintiffs were held to have stated a cause of action under 10b-5 because they allegedly bought stock in the combined company on the strength of those misrepresentations.); cf. *Vine* v. *Beneficial Finance Co.*, 374 F. 2d 627 (2d Cir. 1967) (Corporation fraudulently arranged a merger so that one class of shareholders would receive much less than the other class which was comprised of officers and directors. While the alleged fraudulent acts were committed before plaintiff sold his stock (he had not at the time of suit), he was about to be forced to sell his part of a single fraudulent scheme.).

Another series of decisions involve a broker, dealer or financial institution which fraudulently induced plaintiff's purchase or sale. See *Stockwell* v. *Reynolds & Co.*, 252 F. Supp. 215 (SDNY 1965) (Plaintiffs retained stock in a company solely because a broker misrepresented or failed to disclose certain material facts.); *Glickman* v. *Schweickart & Co.*, 242 F. Supp. 670 (SDNY 1965) (Broker induced plaintiff to purchase some stock and to finance the purchase through a factor without disclosing material facts concern-

ing the risks of such a procedure.); *Cooper* v. *North Jersey Trust Co.*, 226 F. Supp. 972 (SDNY 1964) (Trust company alleged to be a participant in a fraudulent scheme whereby loans were made to plaintiff by a factor who converted the stock when it was pledged as collateral for the loan.); *Meisel* v. *North Jersey Trust Co.*, 218 F. Supp. 274 (SDNY 1963) (same); *Lorenz* v. *Watson*, 258 F. Supp. 724 (E. D. Pa. 1966) (Brokerage house liable to plaintiff if it failed to supervise adequately one of its employees who allegedly was guilty of "churning" or excessive turnover in plaintiff's account.). See also §§9(a)(4), 15(c)(1), (2), 15 U. S. C. §§78i(a)(4); 78o(c)(1), (2). In all of the above cases the defendants, unlike the defendant here, were clearly participants in a securities transaction and were guilty of or responsible for deceptive activities of which the securities transaction was an integral part.

The Injunction Remedy

The remedy of a permanent injunction against the company, its offiicers and agents, the issuance of which the majority leaves to the discretion of the trial court, would not only be inappropriate but would be destructive of fundamental rights—"inappropriate" because based upon one "too-gloomy" press release on April 12, 1964, with no proof of continuing gloominess thereafter. The issuance of any injunction over four years after the alleged violation would place a large company and its many executive employees under the possibility, without even a *Miranda* warning, that anything they say may be held against them and place them under the danger of criminal sanctions; "destructive of fundamental rights" because the restraint constitutes not "double" jeopardy but "perpetual" jeopardy. If, as the majority say, the test of the news release is its impact on the "reasonable" investor (although they indicate that the un-

reasonable speculator, too, comes under their solicitous wing) to avoid the danger of injunction violation it would be necessary to seek a declaratory judgment from the courts (both trial and appellate because following the majority, Rule 52(a) would no longer apply). As to the sufficiency of the news release, the first issue would be what constitutes a "reasonable" investor. After the court had made a preliminary finding of reasonableness, these investors could then testify as to the impact that the proposed release would have on them. Query, as to whether twelve witnesses (akin to a jury) should be required—and would a seven-to-five count be acceptable or would ten-to-two more accurately reflect public opinion? Other situations and problems of an equally *reductio ad absurdum* character can easily be conjured up. They would only point more directly to the conclusion that an injunction here would not only violate fundamental legal principles which for centuries have restricted the injunctive grant but would not be justified by any sufficient factual showing in this case. No clear and present danger, no continuing wrongful acts and no likelihood thereof are to be found in the record before this court.

Crawford, Clayton and Coates

Since I believe that the findings of the trial court are solidly founded and should be respected, I agree with its decision as to Crawford and Clayton. I agree with the majority as to Coates because for all practical purposes the information had not become public at the time of his purchase order.

Conclusion

In summary, the most disturbing aspect of the majority opinion is its utterly unrealistic approach to the problem

of the corporate press release. If corporations were literally to follow its implications, every press release would have to have the same SEC clearance as a prospectus. Even this procedure would not suffice if future events should prove the facts to have been over or understated—or too gloomy or optimistic—because the courts will always be ready and available to substitute their judgment for that of the business executives responsible therefor. But vulnerable as the news release may be, what of the many daily developments in the Research and Development departments of giant corporations. When and how are promising results to be disclosed. If they are not disclosed, the corporation is concealing information; if disclosed and hoped-for results do not materialize, there will always be those with the advantage of hindsight to brand them as false or misleading. Nor is it consonant with reality to suggest, as does the majority, that corporate executives may be motivated in accepting employment by the opportunity to make "secret corporate compensation . . . derived at the expense of the uninformed public." Such thoughts can only arise from unfounded speculative imagination. And finally there is the sardonic anomaly that the very members of society which Congress has charged the SEC with protecting, i.e., the stockholders, will be the real victims of its misdirected zeal. May the Future, the Congress or possibly the SEC itself be able to bring some semblance of order by means of workable rules and regulations in this field so that the corporations and their stockholders may not be subjected to countless lawsuits at the whim of every purchaser, seller or potential purchaser who may claim he would have acted or refrained from acting had a news release been more comprehensive, less comprehensive or had it been adequately published in the news media of the 50 States.

APPENDIX A

Judgment of the United States Court of Appeals for the Second Circuit

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the thirteenth day of August one thousand nine hundred and sixty-eight.

Present:

Hon. J. EDWARD LUMBARD, Chief Judge,
Hon. STERRY R. WATERMAN,
Hon. LEONARD P. MOORE,
Hon. HENRY J. FRIENDLY,
Hon. J. JOSEPH SMITH,
Hon. IRVING R. KAUFMAN,
Hon. PAUL R. HAYS,
Hon. ROBERT P. ANDERSON,
Hon. WILFRED FEINBERG,
Circuit Judges.

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellant,

v.

TEXAS GULF SULPHUR CO., *et al.*,
Defendants-Appellees,

DAVID M. CRAWFORD and RICHARD H. CLAYTON,
Defendants-Appellants.

Appendix A

Judgment of the United States Court of Appeals for the Second Circuit

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order and judgment of said District Court be and they hereby are affirmed in part and reversed in part and that the action be and it hereby is remanded to said District Court for further proceedings below consistent with the opinion of this court.

A. Daniel Fusaro
Clerk

By Vincent A. Carlin
Chief Deputy Clerk

Appendix A

Second Opinion of the District Court

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

65 Civ. 1182

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

TEXAS GULF SULPHUR COMPANY, CHARLES F. FOGARTY, RICHARD D. MOLLISON, RICHARD H. CLAYTON, WALTER HOLYK, KENNETH H. DARKE, DAVID M. CRAWFORD, CLAUDE O. STEPHENS, THOMAS P. O'NEILL, EARLE L. HUNTINGTON and HAROLD B. KLINE,

Defendants.

(6863) BONSAL, D. J.

I. Introduction

This action was instituted by the Securities and Exchange Commission (SEC) pursuant to Sections 21(e) and 27 of the Securities Exchange Act of 1934, 15 U.S.C. §§78u(a) and 78aa (the 1934 Act), against Texas Gulf Sulphur Company (TGS) and several of its officers, directors, and employees. The SEC alleged violations of Section 10(b) of the 1934 Act, 15 U.S.C. §78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, promulgated pursuant thereto. The complaint alleged that from November 12, 1963 through April 16, 1964 certain of the defendants had purchased TGS stock or calls or recommended it to others, or acquired stock options, on the basis of material inside in-

formation concerning the results of TGS's exploration activities near Timmins, Ontario, while such information remained undisclosed to the investing public, the Stock Option Committee, and to TGS shareholders who sold during the period, and that on April 12, 1964, TGS issued a false and deceptive press release with respect to these activities.

All parties agreed that the trial should first be had on the issue of whether the defendants or any of them had violated Section 10(b) or Rule 10b-5, reserving for later hearing the issue of the remedy to be applied in the event such violations were found.

The issue of liability was tried by this court and the court's opinion is reported at 258 F.Supp. 262 (S.D.N.Y. 1966). (6864) The Court of Appeals affirmed in part and reversed and remanded in part, 401 F.2d 833 (2d Cir. 1968) *cert. denied,* 394 U.S. 976 (1969), holding that the defendants who purchased TGS stock or calls, or who recommended such purchases to others, or accepted stock options, before the material information as to the Timmins drill results was disclosed had violated Section 10(b) and Rule 10b-5. The Court of Appeals directed that this court reconsider the April 12 press release (the press release) in light of its opinion.

Beginning on October 6, 1969, this court held a hearing to:

(a) receive further evidence regarding the press release and its interpretation by the reasonable investor; and

(b) determine the remedy to be accorded the SEC with respect to the defendants found to have violated Section 10(b) and Rule 10b-5.

The events which led to this litigation are set forth in detail in the opinion of the Court of Appeals, 401 F.2d at 840-41, 843-47, and in the opinion of this court, 258 F.Supp. at 268-75, 293-94.

II. The April 12, 1964 Press Release

On Sunday, April 12, 1964, at about 3:00 P.M., TGS issued the following press release:

(6865) For Immediate Release

TEXAS GULF SULPHUR COMMENT ON
TIMMINS, ONTARIO, EXPLORATION

New York, April 12—The following statement was made today by Dr. Charles F. Fogarty, executive vice president of Texas Gulf Sulphur Company, in regard to the company's drilling operations near Timmins, Ontario, Canada. Dr. Fogarty said:

"During the past few days, the exploration activities of Texas Gulf Sulphur in the area of Timmins, Ontario, have been widely reported in the press, coupled with rumors of a substantial copper discovery there. These reports exaggerate the scale of operations, and mention plans and statistics of size and grade of ore that are without factual basis and have evidently originated by speculation of people not connected with TGS.

"The facts are as follows. TGS has been exploring in the Timmins area for six years as part of its overall search in Canada and elsewhere for various minerals—lead, copper, zinc, etc. During the course of this work, in Timmins as well as in Eastern Canada, TGS has conducted exploration entirely on its own, without the participation by others. Numerous prospects have been investigated by geophysical means and a large number of selected ones have been core-drilled. These cores are sent to the United States for assay and detailed examination as a matter of routine and on advice of expert Canadian legal counsel. No inferences as to grade can be drawn from this procedure.

"Most of the areas drilled in Eastern Canada have revealed either barren pyrite or graphite with-

out value; a (6866) few have resulted in discoveries of small or marginal sulphide ore bodies.

"Recent drilling on one property near Timmins has led to preliminary indications that more drilling would be required for proper evaluation of this prospect. The drilling done to date has not been conclusive, but the statements made by many outside quarters are unreliable and include information and figures that are not available to TGS.

"The work done to date has not been sufficient to reach definite conclusions and any statement as to size and grade of ore would be premature and possibly misleading. When we have progressed to the point where reasonable and logical conclusions can be made, TGS will issue a definite statement to its stockholders and to the public in order to clarify the Timmins project."

Texas Gulf Sulphur, the world's leading sulphur supplier, has conducted a continuing program of exploration for many years all over the world, searching not only for sulphur, but for oil and gas, metallic sulphides, potash, phosphate, trona and other minerals. This program has been successful, resulting in a broad diversification program from essentially a one-product company. In Moab, Utah, TGS has under way a $40 million potash operation which will be the largest in this country and is expected to start operating this year. The company recently announced a $45 million program to develop phosphate reserves at Lee Creek in North Carolina. The company is also drilling extensively for oil and gas in Western Canada and has other activities under way in trona.

April 12, 1964

(6867) The press release was reported on the Dow Jones broad tape and in the Wall Street Journal, the New

York Herald Tribune, and other morning newspapers throughout the country on April 13, 1964.

The SEC has contended that the press release was materially false and misleading in view of the facts as to the exploratory activities at Timmins at the time of its issuance, and hence violated Rule 10b-5(2) which provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> * * *
>
> (2) to make any untrue statement of a materal fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, * * *
>
> * * *
>
> in connection with the purchase or sale of any security."

In interpreting the "in connection with" requirement of Rule 10b-5, the Court of Appeals held that:

> "* * * Rule 10b-5 is violated whenever assertions are made, as here, in a manner reasonably calculated to influence the investing public * * * if such assertions are false or misleading or are so incomplete as to mislead irrespective of whether the issuance of the release was motivated by corporate officials for ulterior purposes." 401 F.2d at 862.

(6868) To determine whether the press release was false and misleading, the Court of Appeals directed this court to make "an appropriate primary inquiry into the meaning of the statement to the reasonable investor and its relationship to truth." *Ibid.*[1] The Court of Appeals

1. A summary of the exploratory activities at Timmins is set forth in 258 F.Supp. at 269-73 and 401 F.2d at 843-44, 846-47, and are analyzed in 401 F.2d at 862, n. 28.

stated that, "The speculators and chartists of Wall and Bay Streets are also 'reasonable' investors entitled to the same legal protection afforded conservative traders." *Id.* at 849. From the record before it, the Court of Appeals could not,

> "by applying the standard Congress intended, definitely conclude that it was deceptive or misleading to the reasonable investor, or that he would have been misled by it. * * * Accordingly, we remand this issue to the district court that took testimony and heard and saw the witnesses *for a determination of the character of the release in the light of the facts existing at the time of the release,* by applying the standard of whether the reasonable investor, in the exercise of due care, would have been misled by it.
>
> "In the event that it is found that the statement was misleading to the reasonable investor it will then become necessary to determine whether its issuance resulted from a lack of due diligence." *Id.* at 863. (Emphasis added.)

Character of the Release

At the hearing, the court heard the testimony of seven witnesses and received the depositions of 28 witnesses taken prior to the hearing. Twenty shareholders testified that they sold their shares from April 12 through April 16, 1964 because of the press (6869) release. Twelve shareholders testified that they retained their shares or purchased shares after they became aware of the press release. The shareholders stated that they heard of the press release from the Dow Jones broad tape or accounts in the Wall Street Journal or their daily newspapers, published on April 13, 1964, or from their brokers who had obtained the information from these sources.

The shareholders who sold their shares testified that they were misled by certain words in the press release such

as "without factual basis,"[2] "misleading,"[3] "premature,"[4] and "exaggerated,"[5] which indicated to them that the rumors as to the Timmins discovery were unfounded[6] and that there was either no discovery or, if there was, it was not as rich as it was rumored to be.[7]

Nine of the shareholders who sold[8] offered reasons similar to those given by Wentworth who testified:

> "Well, I had noticed that the market on this particular stock was moving up for some little time before that, several weeks, at least * * * And I was curious to know what was causing it, and I supposed at the time that it was because they anticipated larger earnings, maybe increased dividends from their sulphur, potash, and phosphate operations * * * Now * * * when I read this statement in the Wall Street Journal, an officer of the company, I think his name was Fogarty, he mentioned that these rumors—I'm not quoting his exact words, but my recollection of it—he mentioned that these rumors were misleading. I don't remember his exact words, but the substance he was saying was (6870) they were not reliable and misleading. Then I woke up to the fact that this increase in the stock was due to the street rumor, probably, that they had made a find in the Timmins area, and according to my recol-

2. Stotler, Clement, Weinstein, Kane.

3. Stotler, Patenaude, Clement, Kuhlmann, Harutun, Wentworth, Jahss, Kane.

4. Patenaude, Clement, Kuhlmann, Harutun, Jahss.

5. Jay, Weinstein, Ostroff.

6. Stotler, Kane.

7. Jay, Jahss, Kuhlmann.

8. Feeley, Stotler, Patenaude, Kuhlmann, Jay, Harutun, Borden, Ostroff, Kane.

> lection, that stock did dip some at that time.[9] And I decided that the stock had peaked due to these rumors and that instead of holding the stock as it was my original intention, I had better sell it and buy when it went lower."

Shareholders who retained their shares or purchased shares testified that they noted such words as "preliminary"[10] and the promise of a later "definite statement"[11] or considered the press release as a whole. Funk, who purchased shares after reading the Wall Street Journal account of the press release, testified that, "you don't really pick out a line of an article, you have to read between the lines * * * and the total nature of this article was just a cautious approach * * *"

Whereas some shareholders seized upon the words "premature and possibly misleading" to indicate that TGS had no discovery, others testified that these words meant that TGS "had something" but "that they [TGS] didn't know exactly what."[12] Similarly, witness Jay had seized upon the word "exaggerated" to indicate that TGS had no discovery, while Mann testified as to "exaggerated":

> "Well, it wasn't that part of the statement that I regarded as optimistic, but I think he was referring to the criticism that Canadian authorities were making which were published, that there were all kinds of (6871) wild rumors, not only of Texas Gulf Sulphur, but of many other mining companies in Canada, and

9. Whereas the price of TGS did begin to drop after April 12, movement of TGS stock prices was nearly identical to that of Freeport Sulphur and Pan American Sulphur. The closing prices on the three stocks on April 10, 13, 14, and 15, 1964, were as follows: TGS (30⅛, 30⅞, 30¼, 29⅜—drop of ¾); Freeport (38½, 39½, 39, 38—drop of ½); Pan American (33⅞, 33⅞, 32¼—drop of 1⅝).

10. Rhodes, Gwynne, Mann.

11. Gwynne, Crowley, Mann.

12. Shimberg Wochnik.

> the market was going too high, there was no basis for it."

All of the shareholders appear to have been reasonable investors as that term has been defined by the Court of Appeals, and all were influenced by the press release, some selling their shares, and others holding their shares or purchasing shares.

Finding that the witnesses were reasonable investors, the court is next directed to determine whether those who sold their shares were misled by the press release. The Court of Appeals stated that, "Examined in retrospect, the situation in Timmins at the time the release was prepared seems to offer good reason for optimism." *Id.* at 862, n.28. In his concurring opinion, Judge Friendly found that, "To say that the drilling at Timmins had afforded only 'preliminary indications that more drilling would be required for proper evaluation of this prospect,' was a wholly insufficient statement of what TGS knew * * *" *Id.* at 866. Judge Hays, concurring in part and dissenting in part, held that, "* * * the evidence establishes as a matter of law that the press release was misleading. Indeed, if the correct standard is applied, the finding of the trial court requires the conclusion that the press release was misleading * * *" *Id.* at 869. Also, the press release has been held to be "* * * misleading, intentionally deceptive, inaccurate, and (6872) knowingly deficient in material facts pertaining to the results of drilling." *Reynolds* v. *Texas Gulf Sulphur Co.*, —— F. Supp. ——, ¶92,494 CCH Fed. Sec. L. Rep. 98,317 (D. Utah, October 17, 1969). Revised opinion filed January 13, 1970.

The testimony of the witnesses who sold their shares at a time when the situation in Timmins "seem[ed] to offer good reason for optimism" establishes that they sold because of the press release, and that they were misled by it. It was not necessary that the SEC establish that the selling shareholders were influenced to sell their shares

solely because of the press release. It is enough that it materially influenced the shareholders' conduct and was a substantial factor in bringing about their sales. *See* Prosser, *Law of Torts,* §103, p. 730 (1964).

The court must next determine whether the reasonable investors who were misled by the press release would have been so misled had they exercised due care. TGS argues that no reasonable investor exercising due care would have been misled and caused to sell his stock on the basis of the press release. Emphasizing the promise of a "definite statement" at a future time "[w]hen we have progressed to the point where reasonable and logical conclusions can be made. * * *" TGS urges that the exercise of "due care" required that the shareholders await the further statement before selling their shares. Kane testified, however, that he decided to sell and not await the promised statement (6873) because:

> "I decided that the statement as issued April 12th and quoted in the Wall Street Journal on April 13th, was emphatic enough and strong enough for me to base an investment decision on."

Since the press release had misled reasonable investors to believe that there was no ore discovery, or if there was, it was not as rich as it was rumored to be, they were entitled to act without awaiting a second release.

Therefore, the court finds that some reasonable investors, exercising due care, were misled by the press release.

Due Diligence

There remains the question whether the framers of the press release failed to exercise due diligence.[13] The Court of Appeals stated that:

13. "The trial court did not find it necessary to decide whether TGS exercised such diligence and has not yet attempted to resolve this issue. While the trial court concluded that TGS had exercised 'rea-

> "In the event that it is found that the statement was misleading to the reasonable investor it will then become necessary to determine whether its issuance resulted from a lack of due diligence." *Id.* at 863.

However, the majority opinion goes on to say:

> "It is not altogether certain from the present record that the draftsmen could, as the SEC suggests, have readily obtained current reports of the drilling progress over the weekend of April 10-12, but they certainly should have obtained them if at all possible for them to do so. However, even if it were not possible to evaluate and transmit current data in time to prepare the release on April 12, it would seem that TGS could have delayed the preparation a bit until an accurate report of the rapidly changing situation was possible. See 258 F.Supp. at 296. At the very least, if TGS felt (6874) compelled to respond to the spreading rumors of a spectacular discovery, it would have been more accurate to have stated that the situation was in flux and that the release was prepared as of April 10 information rather than purporting to report the progress 'to date.' Moreover, it would have obviously been better to have specifically described the known drilling progress as of April 10 by stating the basic facts. Such an explicit disclosure would have permitted the investing public to evaluate the 'prospect' of a mine at Timmins without having

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sonable *business* judgment under the circumstances' 258 F.Supp. at 296 (emphasis supplied) it applied an incorrect *legal* standard in appraising whether TGS should have issued its April 12 release on the basis of the facts known to its draftsmen at the time of its preparation, 258 F. Supp. at 295, and in assuming that disclosure of the full underlying facts of the Timmins situation was not a viable alternative to the vague generalities which were asserted. 258 F. Supp. at 296." *Id.* at 863. (emphasis in original.)

to read between the lines to understand that preliminary indications were favorable—in itself an understatement.

> "The choice of an ambiguous general statement rather than a summary of the specific facts cannot reasonably be justified by any claimed urgency. The avoidance of liability for misrepresentation in the event that the Timmins project failed, a highly unlikely event as of April 12 or April 13, did not forbid the accurate and truthful divulgence of detailed results which need not, of course, have been accomplished by conclusory assertions of success. Nor is it any justification that such an explicit disclosure of the truth might have 'encouraged the rumor mill which they were seeking to allay.' 258 F. Supp. at 296." *Id.* at 863-64.

Judge Friendly, in his concurring opinion, stated that the press release "* * * was a wholly insufficient statement of what TGS knew," *Id.* at 866, and Judge Hays, concurring in part and dissenting in part, added:

> "* * * since Fogarty and those who assisted him in the preparation of the press release were aware of the drilling results to which the district court's finding refers, they obviously did not use due diligence in the preparation of the misleading press release." *Id.* at 869-70.

(6875) From the foregoing, it appears that a majority of the Court of Appeals were of the view that the framers of the press release failed to exercise due diligence. No additional evidence was presented at the hearing supporting TGS's contention that the framers exercised due diligence.

While the Court of Appeals recognizes that "* * * the timing of disclosure is a matter for the business judgment

of the corporate officers * * *," *Id.* at 850, n.12, when a company chooses to issue a press release to respond to spreading rumors regarding its activities, it must describe the true picture at the time of the press release, which should include the basic facts known, or which reasonably should be known to the draftsmen of the press release, enabling the investing public to make a reasonable appraisal of the existing situation.[14]

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14. Where technical geological data is involved, consideration should be given to a recent release of the SEC regarding the effect of corporate disclosure upon the investing public in the related petroleum field. Portions of the release, issued on October 20, 1969, and entitled, "Publicity Concerning Petroleum Discoveries on North Slope of Alaska," follow:

> "The Securities and Exchange Commission today expressed its concern with the effect which publicity being given the oil and gas discoveries in the North Slope area of Alaska may have upon public investors. Such publicity may stimulate public interest and give rise to estimates of potential values beyond justification by the factual information now available. * * *
>
> "Oil companies which have oil exploration and development interests on the North Slope are cautioned to weigh carefully the conclusions and interpretations of information they may use in statements released to the public * * * which describe the results of exploration and drilling programs which have been carried out.
>
> "It is the policy of the Commission to encourage prompt disclosure of material developments in the affairs of publicly owned companies. Such disclosure, however, should not be false or misleading. * * *
>
> "* * * Investors unfamiliar with the technical aspects of the oil and gas business—and these may include most shareholders of major oil companies—could ignore or miscontrue the difference between categories of reserves and would attribute to any numerical estimates of reserves in other categories [than 'proved'] a degree of certainty which is not warranted.* While the absence of proved reserve does not preclude factual disclosures of exploratory activities such as information relating to drilling operations, any statements which are made should be appropriately qualified to indicate the limitations upon the significance of the facts disclosed."
>
> * See *Sunray DX Oil Co.* v. *Helmerich & Payne, Inc.*, 398 F.2d 447 (10th Cir. 1968).

On the basis of the standards laid down by the Court of Appeals, this court finds that the framers of the press release failed to exercise due diligence. Therefore, the press release is found to have been misleading to the reasonable investor using due care, and since the framers did not exercise due diligence in its issuance, TGS violated Section 10(b) and Rule 10b-5.

TGS contends that it can only be held responsible for the press release itself, not for the "inaccurate or incomplete" (6876) version carried by the news media, and emphasizes that none of the witnesses who sold their shares actually saw the press release. TGS refers in particular to the Dow Jones broad tape transmission of April 13, which follows:

"April 13, 1964

"TEXAS GULF SULPHUR

"TEXAS GULF SULPHUR CO CALLED REPORTS THAT IT HAS DISCOVERED A LARGE LODE OF RICH COPPER ORE IN CANADA—PREMATURE AND POSSIBLY MISLEADING—RUMORS OF A GIANT COPPER STRIKE NEAR TIMMINS ONTARIO CAUSED HEAVY TRADING IN MINING STOCKS FRIDAY ON THE TORONTO STOCK EXCHANGE—CHARLES F FOGARTY EXECUTIVE VICE PRESIDENT OF TEXAS GULF SULPHUR ISSUED A STATEMENT SAYING THE REPORTS—EXAGGERATE THE SCALE OF OPERATIONS AND MENTION PLANS AND STATISTICS OF SIZE AND GRADE OF ORE THAT ARE WITHOUT FACTUAL BASIS AND HAVE EVIDENTLY ORIGINATED BY SPECULATION OF PEOPLE NOT CONNECTED TITH [sic] TGS—"

TGS claims that the Dow Jones paragraph is an incomplete restatement of the press release. In particular, the company points to the omission of its promise that "[w]hen we (6877) have progressed to the point where reasonable and logical conclusions can be made, TGS will issue a definite statement * * *"

TGS also contends that the Wall Street Journal distorted the release by taking the words "without factual

basis" out of context and using them as a sub-headline, which the company thinks may have given the impression that they had denied even the possibility that a strike might be proven through further drilling.

By issuing the press release "For Immediate Release," TGS was depending on the news media to report it to its shareholders. They could not have expected the news media to publish the entire press release, but only those portions which the media deemed important. Had TGS considered it important that its shareholders be presented with the full text of the press release, TGS could have sent individual copies to each shareholder through the mails.

Indeed, the fact that the news media emphasized the words which have been found to be misleading to the reasonable investor merely indicates that the news media also deemed them of importance. The failure of the broad tape to mention that a later statement would be issued indicates only that Dow Jones considered it relatively unimportant. No evidence was adduced at the hearing to establish unfair treatment by the news media.

(6878) *Application for an Injunction*

Having found that TGS violated Section 10(b) and Rule 10b-5, the court must now determine whether the SEC is entitled to an injunction. The SEC seeks a permanent injunction, pursuant to Section 21(e) of the 1934 Act, restraining TGS from violating Section 10(b) and Rule 10b-5 in connection with the issuance of future corporate announcements to the public. Section 21(e) provides in pertinent part:

> "Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of

> any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States * * * to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted. * * *"

The Supreme Court has made it clear that "the cessation of violations, whether before or after the institution of a suit * * * is no bar to the issuance of an injunction * * *" and that the issuance of an injunction is subject to principles of equitable discretion. *Hecht Co.* v. *Bowles,* 321 U.S. 321, 327 (1944).

Section 21(e) requires that "a proper showing" be made before a permanent injunction may be granted. In *S.E.C.* v. *Culpepper,* 270 F.2d 241, 249 (2d Cir. 1959), the Court of Appeals stated that, "The critical question for the court in cases such (6879) as this is whether there is a reasonable expectation that the defendants will thwart the policy of the Act by engaging in activities proscribed thereby." Mr. Justice Clark observed in *United States* v. *W. T. Grant Co.,* 345 U.S. 629, 633 (1953):

> "The case may nevertheless be moot if the defendants can demonstrate that 'there is no reasonable expectation that the wrong will be repeated.' The burden is a heavy one. * * *
>
> "Along with its power to hear the case, the court's power to grant injunctive relief survives discontinuance of the illegal conduct. The purpose of an injunction is to prevent future violations, and, of course, it can be utilized even without a showing of past wrongs. But the moving party must satisfy the court that relief is needed. The necessary determination is that there exists some cognizable danger of recurrent violation, something more than

> the mere possibility which serves to keep the case alive." (citations omitted.)

Professor Loss has suggested that, "The ultimate test is whether the defendant's past conduct indicates * * * that there is a reasonable likelihood of further violations in the future." 3 Loss, *Securities Regulation,* 1976 (1961).

In its earlier opinion this court stated:

> "[I]t is apparent that the purpose of the April 12 press release was an attempt to meet the rumors which were circulating with respect to the Kidd 55 segment.
>
> * * *
>
> "Moreover, the circumstances under which the April 12 release was prepared indicate that the defendants Fogarty and Mollison were under considerable pressure. If they had said too much, they would have been open to criticism and possible liability if it turned out that TGS had not discovered a commercial mine. If they said too little and later announced a mine, they subjected themselves to the charge that (6880) their press release was misleading or deceptive—and, indeed, this is what has happened. If they had announced the drilling results in terms of number of drill holes, footage drilled and mineralization intersected, they would have encouraged the rumor mill which they were seeking to allay. Perhaps they should have waited until they could have obtained more probative information before issuing a press release, particularly since developments were breaking so rapidly. However * * * TGS must not be judged by hindsight. In seeking the advice of Mollison, the head of TGS's exploration group, in consulting with TGS's public relations firm, and in clearing the release with one

> of TGS's lawyers, Stephens and Fogarty exercised reasonable business judgment under the circumstances." 258 F.Supp. at 294, 296.

In the Court of Appeals, Judge Friendly observed in his concurring opinion that while the press release did not properly convey the information in the hands of the draftsmen on April 12,

> "[I]t does not necessarily follow that this is an appropriate case for granting an injunction as to future press releases. * * * Here there is no danger of repetition of an unduly gloomy press release like that of April 12. The essence of the SEC's case is that Timmins was a once-in-a-lifetime affair; the company's motive in issuing the release was laudable; and the defect was solely a pardonable one of execution." 401 F.2d at 868-69.

The issuance of an injunction is inappropriate absent a showing of lack of good faith. "Scienter and Rule 10b-5," 69 Col. L. Rev. 1057, 10[illegible]6 (1969); 82 Harv. L. Rev. 938, 947-48 (1969).

(6881) Finally, the Court of Appeals' "due diligence" test is here being applied for the first time.

On the record here, there is no "proper showing" that there is any reasonable likelihood of future violations by TGS of Section 10(b) and Rule 10b-5. The press release was issued over five years ago, and no subsequent misleading press releases have been called to the court's attention.

Accordingly, the SEC's application for "the issuance of a final judgment permanently enjoining the defendant TGS * * * from issuing, publishing, distributing or otherwise disseminating materially false, misleading, inadequate, or inaccurate press releases and other communica-

tions and reports concerning material facts about TGS's activities and operations" is denied.[15]

III. Remedy as to the Individual Defendants

This court found that defendants Clayton and Crawford had violated Section 10(b) and Rule 10b-5 in that they purchased TGS stock on the basis of material inside information concerning the results of TGS drilling in Timmins, Ontario, while such information remained undisclosed to the investing public. The Court of Appeals affirmed this court's determination as to Clayton[16] and Crawford and in addition ruled:

(6882) (1) that defendants Fogarty, Mollison, Darke, Huntington, Holyk, and Coates had violated Section 10(b) and Rule 10b-5 in that they purchased TGS stock or calls on the basis of material undisclosed information; (2) that defendants Darke and Coates[17] had violated Section 10(b) and Rule 10b-5 in that they recommended the purchase of TGS stock to others while the material information was undisclosed to the investing public; and (3) that defendants Stephens, Fogarty, and Kline had violated Section 10(b) and Rule 10b-5 in that they accepted stock options without disclosing the material information to the Stock Options Committee or the Board of Directors of TGS.[18]

15. This renders it unnecessary to consider TGS's defense that the issuance of an injunction would violate the company's rights under the First Amendment.

16. While this court found that only Clayton's purchase on April 15, 1964 was a violation of Section 10(b) and Rule 10b-5, the Court of Appeals held that all of his purchases during the period of nondisclosure, from November 12, 1963 through April 16, 1964, were violations of these provisions.

17. A stipulation was signed by the parties settling the SEC's action against Coates, and a judgment was entered pursuant thereto on October 2, 1969.

18. Defendant O'Neill has not appeared or answered. A motion by the SEC to enter a default judgment against him was denied by this court without prejudice to its renewal following final disposition of the appeal, and the SEC renewed its motion of September 26, 1969. Disposition of the motion will be the subject of a separate memorandum.

There remains for determination the appropriate remedy to be applied to these defendants.

Defendants Who Purchased or Recommended Purchases of Stock or Calls

With respect to the defendants who were found to have violated Section 10(b) and Rule 10b-5 in that they purchased TGS stock or calls or recommended its purchase to others while in possession of material undisclosed inside information, the SEC urges that the court:

(6883) 1) issue an order under Section 21(e) of the 1934 Act enjoining,

Injunctive Relief—

a) defendants Clayton, Holyk, Huntington, Darke, Fogarty, Crawford, and Mollison from violating Section 10(b) and Rule 10b-5 in connection with their purchases or sales of the securities of TGS (or calls in TGS securities) on the basis of material undisclosed inside information;

b) defendant Darke from recommending the purchase of TGS stock while in possession of material undisclosed inside information; and

Other Relief—

2) decree that defendants Clayton, Holyk, Huntington, and Darke be deprived of the profits they realized through their use of material undisclosed inside information and that defendant Darke be required to pay an amount equal to the profits of those persons who purchased TGS

stock on his recommendation or that of his "tippees."[19]

Injunctive Relief

The SEC asserts that the defendants' past violations were not accidental or inadvertent, but knowing, and that the fact that defendants continue to maintain that they have done nothing wrong creates a reasonable expectation that such violations will occur in the future unless an injunction issues. Moreover, the SEC points out that all these defendants, with the exception of Darke, still hold important positions with TGS—positions which presumably bring material confidential information to their attention.

(6884) On the other hand, these defendants emphasize that the only transactions for which they have been held to have violated Rule 10b-5 occurred more than five years ago and that there is no evidence that since that time they have violated the securities laws, or are about to violate them. Defendants rely on *Hecht Co.* v. *Bowles*, 321 U.S. 321, 329 (1944) and *Electronics Specialty Co.* v. *International Controls Corp.*, 409 F.2d 937, 947 (2d Cir. 1969), for the proposition that, "The historic injunctive process was designed to deter, not to punish." It would be inappropriate, these defendants say, to enjoin them "for failing to have the prescience to know that their conduct would be adjudged unlawful under a statute and rule which did not expressly prohibit that conduct and which had not previously been interpreted to prohibit it." Finally, defendants urge the court to consider the punishment they have already suffered by reason of the wide adverse publicity.

19. As defendants Fogarty, Mollison, and Crawford have sold the shares which they purchased from November 12, 1963 through April 16, 1964 to TGS at cost, the SEC seeks no relief other than an injunction with respect to them.

In considering the remedy of injunction, it is noted that defendant Darke is a Canadian living in Canada. He is no longer in the employ of TGS, and hence no longer privy to any material inside information with respect to its activities. The material undisclosed information possessed by Darke when he made his purchases and recommended TGS securities to others was disclosed in the April 16, 1964 press release (6885) announcing TGS's discovery. The SEC seeks injunctions only with respect to trading in TGS securities on the basis of TGS material undisclosed information. Since Darke no longer has the opportunity, no useful purpose would be served by the issuance of an injunction, but the SEC will be accorded "other relief" to the extent hereinafter provided.

Defendants Holyk, Huntington, Fogarty, and Mollison are still in the employ of TGS. The record makes it clear that the discovery on the Kidd 55 segment was a once-in-a-lifetime affair. The violations occurred more than five years ago, and there is no evidence that any of these defendants have been guilty of further violations. Professor Painter points out that the application of the "materiality" test by the Court of Appeals "represents a considerable extension of the meaning of 'materiality' into new areas." Painter, *Federal Regulation of Insider Trading,* 220 (1969). These defendants could not have anticipated this extension at the time of their violations, but they, as indeed all insiders, are now on notice of the scope of Section 10(b) and Rule 10b-5. It is believed that the wide publicity accorded to these defendants will serve as an adequate deterrent, when coupled with the fact that none of these defendants will retain the profits which they realized by reason of their violations. Fogarty and Mollison have (6886) surrendered to TGS, at their cost, the shares which they purchased, and by the applications of the "other relief" sought by the SEC, Holyk and Hunting-

ton will be deprived of any profit they made by reason of their violations. The purpose of an injunction is to deter and not to punish. *Hecht Co.* v. *Bowles, supra; Electronics Specialty Co.* v. *International Controls Corp., supra.*

For the foregoing reasons, finding no reasonable likelihood of further violations, injunctions will not issue with respect to defendants Darke, Holyk, Huntington, Fogarty, and Mollison.

Defendants Clayton and Crawford are in a different position because they purchased during the period of nondisclosure knowing beyond peradventure of a doubt that TGS had made a very important mineral discovery. Because of this and reasons hereinafter stated, injunctions will issue with respect to them.

Other Relief

The SEC urges the court to deprive defendants Darke, Holyk, Huntington, and Clayton of their profits in order to remove any monetary reward for violations of Section 10(b) and Rule 10b-5.

The defendants contend that the SEC's only remedy is for an injunction or restraining order under Section 21(e), (6887) and that this court has no power to direct "other relief," whether or not ancillary to an injunction.

Judicial willingness to imply new remedies in areas governed by federal law has been expressed in a number of ways. *See* Comment, "SEC Enforcement of the Rule 10b-5 Duty to Disclose Material Information—Remedies and the Texas Gulf Sulphur Case," 65 Mich. L. Rev. 944, 945-54 (1967).

When such relief has been necessary for the protection of the investing public, the courts have utilized their inherent equity power to grant relief ancillary to an injunction. Thus a receiver was appointed ancillary to an injunc-

tion under Section 21(e) in *S.E.C.* v. *H.S. Simmons & Co.*, 190 F.Supp. 432 (S.D.N.Y. 1961), and in *S.E.C.* v. *Wong*, 252 F.Supp. 608, 613 (D.P.R. 1966), the court, denying defendant's motion to dismiss that portion of the SEC's complaint seeking an accounting and restitution, stated that, "Where appropriate, this Court may utilize its inherent equity powers, invoked by an injunctive action under Section 36 [of the Investment Company Act, 15 U.S.C. §80a-35], to do justice and grant full relief."

Ancillary relief in other areas[20] indicates that the doctrine is sufficiently well established to support the relief here sought by the SEC if the congressional purpose is effectuated by so doing. *See*, 65 Mich. L. Rev., *supra* at 946-48, (6888) 3 Loss, *supra* at 1827-28; Cary, Book Review, 75 Harv. L. Rev. 857, 861 (1962); "Ancillary Relief in SEC Injunction Suits for Violation of Rule 10b-5," 79 Harv. L. Rev. 656 (1966).

In *Textile Workers* v. *Lincoln Mills*, 353 U.S. 448 (1957), the Supreme Court held that the congressional grant of jurisdiction in Section 301(a) of the Labor Management Relations Act of 1947, 29 U.S.C. §185, "authorize[d] federal courts to fashion a body of federal law for the enforcement of these collective bargaining agreements * * *." *Id.* at 451, and that the law to be applied in such suits "is federal law, which the courts must fashion from the policy of our national labor laws." *Id.* at 456.

This action was instituted pursuant to Section 27 of the 1934 Act, which provides:

> "The district courts of the United States * * * shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought

20. *Porter* v. *Warner Holding Co.*, 328 U.S. 395 (1946)—Emergency Price Control Act of 1942; *Mitchell* v. *Robert DeMario Jewelry, Inc.*, 361 U.S. 268 (1960)—Fair Labor Standards Act of 1938.

> to enforce any liability or duty created by this chapter or the rules and regulations thereunder."

In *J.I. Case Co.* v. *Borak,* 377 U.S. 426, 433 (1964), the Supreme Court, invoking the *Lincoln Mills* rationale, and basing its determination on Section 27 rather than on either the ancillary or statutory tort doctrines, stated that:

> (6889) "* * * it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose * * *. It is for the federal courts 'to adjust their remedies so as to grant the necessary relief' where federally secured rights are invaded."

The Supreme Court recently followed this rationale in *Mills* v. *Electric Auto-Lite Co.,* —— U.S. ——, 38 U.S.L.W. 4097 (Jan. 20, 1970). The Court concluded that proxies necessary to the approval of a merger were obtained by means of a materially misleading solicitation. *Id.* at 4100. In stating that the conclusion implied nothing about the form of the relief to which plaintiffs were entitled, Justice Harlan went on to say:

> "We held in *Borak* that upon finding a violation the courts were 'to be alert to provide such remedies as are necessary to make effective the congressional purpose,' noting specifically that such remedies are not to be limited to prospective relief. 377 U.S., at 433, 434. * * * In selecting a remedy the lower courts should exercise 'the sound discretion which guides the determination of courts of equity,' keeping in mind the role of equity as 'the instrument for nice adjustment and reconciliation between the public interest and private needs as well as between competing private claims. *Hecht Co.* v. *Bowles,* 321 U.S. 321, 329-330 (1944)." *Ibid.*

In contrasting the Lanham Act, Justice Harlan said:

> "[W]e cannot fairly infer from the Securities Exchange Act of 1934 a purpose to circumscribe the courts' power to grant appropriate remedies." *Id.* at 4101.

As this court has recently stated in *Astor* v. *Texas Gulf Sulphur Co.*, —— F.Supp. —— (S.D.N.Y. 1969), ¶92,501 CCH Fed. Sec. L. Rep. 98,341, 98,345 (Oct. 31, 1969):

> (6890) "The power of the federal courts to 'adjust their remedies' where Rule 10b-5 has been violated, *J.I. Case Co.* v. *Borak, supra* at 433, may be invoked in situations of 'inherent unfairness * * * where a party takes advantage of [undisclosed corporate] information knowing it is unavailable to those with whom he is dealing, *Cady, Roberts & Co.*, 40 S.E.C. 907, 912 (1961)."

Therefore, the court may, on the basis of Section 27, fashion an appropriate remedy to effectuate the purpose of the 1934 Act, and to deter future violations of Section 10(b) and Rule 10b-5. 65 Mich. L. Rev., *supra* at 954.

The congressional purpose is stated in Section 2 of the 1934 Act (15 U.S.C. §78(b), which provides in part:

> "[T]ransactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary * * * to insure the maintenance of fair and honest markets in such transactions."

In *Burko* v. *S.E.C.*, 316 F.2d 137, 141 (2d Cir. 1953), the Court of Appeals, discussing the 1934 Act, remarked:

> "[I]t is important to remember that the Commission is charged with the duty of enforcing the statute in

> the 'public interest,' * * * and that its orders are intended to be remedial rather than penal, a result of the fact that the 'design of the statute is to protect investors' and the general public in this specialized field."

In seeking to deprive the defendants of their profits in order to remove any monetary reward for violating Section 10(b) and Rule 10b-5, the SEC is urging this court to (6891) provide a remedy which will, in accord with the congressional purpose of the 1934 Act, protect the investing public by providing an effective deterrent to future violations. *See,* 65 Mich L. Rev., *supra* at 963. Accordingly, the court may require the defendants to give up profits realized in transactions which violated Section 10(b) and Rule 10b-5.[21]

Defendants contend that even if this court has the power, the SEC's "other relief" should be denied in the court's discretion. They assert that, "[I]f a sum of money is to be recovered by a third person for violation of a statute instead of the person injured * * * it constitutes a penalty. * * *" *Bowles* v. *Farmers National Bank,* 147 F.2d 425, 428 (6th Cir. 1945), and that, "Anything which savors of a penalty should not be permitted unless Congress has expressly so provided, since the spirit of equity abhorred such punitive measures." *United States* v. *Parkinson,* 240 F.2d 918, 922 (9th Cir. 1956). Defendants also point out that the amount of their profits which the SEC seeks to deprive them of exceeds the statutory maximum fine

21. On October 10, 1969, Judge Weinfeld of this Court entered a judgment, based upon a stipulation between the parties, enjoining future violations and directing the defendants to surrender their profits in *S.E.C.* v. *Golconda Mining Co.,* ¶92,564 CCH Fed. Sec. L. Rep. 98,367 (S.D.N.Y. 1969), an action alleging that defendants violated Section 10(b) and Rule 10b-5 by trading on the basis of inside information.

which could have been levied upon them if they had been found guilty of a criminal violation.

However, as stated by the New York Court of Appeals in *Diamond* v. *Oreamuno,* 301 N.Y.S.2d 78, 81, 24 N.Y.2d 449 (N.Y. Ct. App. 1969),

> (6892) "[T]here can be no justification for permitting officers and directors, such as the defendants, to retain for themselves profits which * * * they derived solely from exploiting information gained by virtue of their inside position as corporate officials."

In its complaint filed in this action, the SEC sought rescission and restitution with respect to defendants who purchased TGS stock or recommended its purchase to others while in possession of material undisclosed information. The SEC now urges that the court follow the formula established in its settlement with defendant Coates, which was approved by this court on October 2, 1969. The Coates settlement provided that he would pay to TGS the estimated amount of "profit" based upon the difference between market price on April 17, 1964 and the price at which the stock was purchased on April 16, 1964. The settlement was $26,250. of which $16,575. represented the "profit" on the stock purchased by Coates for his family trusts, and $9,675. represented the "profit" on stock purchased by Coates' "tippees."

In applying this formula, the SEC proposes that the amount to be paid by each defendant would be the difference between the mean average price of TGS common stock on the New York Stock Exchange on April 17, 1964, which has been stipulated by the parties to be 40⅜, and the purchase price of (6893) their shares, and in the case of calls, the aggregate of the purchase price and the cost of

exercise, with interest from April 17, 1964 at the New York legal rate.[22]

The payments would be made to TGS to be held in escrow in an interest-bearing account for a period of three or more years, subject to disposition in such manner as the court might direct upon application by the SEC or other interested person or on the court's own motion. At the end of the period any money remaining undisposed of would become the property of TGS.[23]

The formula proposed by the SEC is approved as fair. TGS announced its major discovery on the morning of April 16, 1964. The news was widely disseminated by the news media and was available to the investing public on April 17, 1964.[24]

The court believes that the application of the SEC formula to the extent hereinafter provided with respect to each individual defendant will protect the investing public by deterring possible future violations of Section 10(b) and Rule 10b-5. To the payments hereinafter directed to be made, interest will be added at the rate of 6% per

22. It has been stipulated that prior to July 1, 1968, the New York legal rate was 6%; from July 1, 1968 to February 16, 1969 it was 7¼%; and since February 16, 1969, has been 7½%.

23. The Coates settlement included the following provision:

> "* * * except that if Coates or his estate shall incur liability to any person or entity by reason of his purchases of Texas Gulf stock on April 16, 1964, or the purchases of said stock by H. Fred Haemisegger and his customers, as a result of a judgment in or settlement of any other action commenced prior to the date hereof, Texas Gulf will, at the request of Coates or his estate, apply any or all of the remaining balance of said amount toward the satisfaction of such liability."

24. In *Reynolds* v. *Texas Gulf Sulphur Co., supra,* the court used the average of the highest prices on the 20 days following the April 16, 1964 press release as the standard for computing the damages of plaintiffs who sold their TGS stock in reliance on the April 12, 1964 press release.

annum from April 17, 1964, and the payments will be escrowed by TGS for a period of 5 years. Each of these defendants will now be considered:

(6894) *Darke*—Defendant Darke was a geologist and a member of TGS's exploration group on the Kidd 55 segment. During the period of nondisclosure, from November 12, 1963 through April 16, 1964, Darke made the following purchases:

Date of Purchase	*Shares*		*Calls*	
	Number	*Price*	*Number of Shares*	*Cost of Exercise*
2/20/64	300	24⅛		
2/27/64			1,000	22⅝-22¾
3/23/64			1,000	24¾
3/30/64			1,000	25½

Darke purchased a total of 300 shares and calls on 3,000 shares. Under the SEC formula, his cost is figured at $91,442.58. The price on April 17, 1964, was $133,237.50. Accordingly, Darke will be directed to pay the difference of $41,794.92 to TGS.

During the period of nondisclosure, Darke recommended the purchase of TGS securities to the following persons, whose purchases were as follows:

Date of Purchase	*Purchaser*	*Shares*		*Calls*	
		Number	*Price*	*Number of Shares*	*Cost of Exercise*
12/30/63	Caskey			300	22¼
2/17/64	Atkinson	50	23¼	200	23⅛
3/ 3/64	E.W.Darke			500	22½-22⅝
3/17/64	E.W.Darke			200	23⅜
3/30/64	Atkinson			400	25¾-25⅞
3/30/64	Caskey	100	25⅞	1,000	25¾-25⅞
3/30/64	E.W.Darke			200	25½

(6895) During the period of nondisclosure, the following persons purchased TGS securities on the basis of rec-

ommendations received directly or indirectly from Caskey or Atkinson:

Date of Purchase	*Purchaser*	*Shares*		*Calls*	
		Number	*Price*	*Number of Shares*	*Cost of Exercise*
1/16/64	Westreich	2,000	21¼-21¾		
2/17/64	Westreich	50	23¼	1,000	23¼-23⅝
2/24/64	Miller			200	23¾
2/25/64	Miller			300	23⅜-23½
3/30/64	Klotz			2,000	25½-26⅛
3/30/64	Miller			500	25½-25⅞
3/30/64	Westreich	500	25¾		

As to Darke's "tippees," this court stated:

> "Toward the end of December, 1963, Darke visited Caskey and Atkinson in Washington. The evidence shows no more than that Darke indicated to them that he thought TGS was a good buy. There is no direct evidence that Darke again communicated with any of his 'tippees,' but the record shows that on March 30, 1964, Darke and his 'tippees,' Atkinson, Caskey, E. W. Darke, Klotz, Miller, and Westreich, purchased substantial amounts of TGS stock and calls on TGS stock. As the Commission points out, this is strong circumstantial evidence that Darke must have passed the word to one or more of his 'tippees' that drilling on the Kidd 55 segment was about to be resumed." 258 F.Supp. at 284.

The Court of Appeals added:

> "Obviously if such a resumption were to have any meaning to such 'tippees,' they must have previously been told of K-55-1.
>
> "* * * As it is our holding that the information acquired after the drilling of K-55-1 was material,

> we, on the basis of the findings of direct and (6896) circumstantial evidence on the issue that the trial court has already expressed, hold that Darke violated Rule 10b-5 (3) and Section 10(b) by 'tipping' and we remand, pursuant to the agreement of the parties, for a determination of the appropriate remedy. 401 F.2d at 852 (footnote omitted).

The SEC urges that Darke be required to pay an amount equal to the profits of his "tippees." Accordingly to the SEC's calculations, the profit of Darke's "tippees" which is attributable to him was $141,818.14, as follows:

"Tippee"	*Total Cost*	*Price on 4/17/64*	*Profit Attributable to Darke*
Caskey	$31,772.74	$ 56,625.00	$24,752.26
Atkinson	17,841.43	26,243.75	8,402.32
*E. W. Darke	21,087.50	36,337.50	15,250.00
Westreich	86,275.65	143,331.25	57,056.20
Klotz	56,770.32	80,750.00	23,979.68
Miller	27,997.32	40,375.00	12,377.68
			$141,818.14

*E. W. Darke, the brother of defendant Darke, is a Canadian resident. The SEC has been unable to determine both the cost of the calls purchased by E. W. Darke and whether these calls were exercised. Since the price of TGS stock rose appreciably above the exercise price of these calls, the SEC has assumed that they were exercised.

In considering "other relief" with respect to Darke's "tippees," a distinction will be made between those who purchased TGS securities on Darke's recommendation and those who purchased on the recommendation of one of Darke's "tippees."

(6897) In this court's opinion it will be a sufficient deterrent if Darke is directed to pay to TGS the profits

realized by the "tippees" who purchased on Darke's recommendation (E. W. Darke, Caskey, and Atkinson) in accordance with the SEC formula.

E. W. Darke, Caskey, and Atkinson purchased a total of 150 shares and calls on 2,800 shares. Under the SEC formula, their cost is figured at $70,701.67. The price on April 17, 1964, was $119,106.25, and Darke will be directed to pay the difference of $48,404.58 to TGS—subject to adjustment if Darke furnishes the exact figures as to his brother's purchases of calls and evidence as to whether his brother exercised them—which amount is in addition to the $41,794.92 Darke will be directed to pay with respect to his own purchases.

Holyk—Defendant Holyk was the chief geologist in TGS's exploration group on the Kidd 55 segment. During the period of nondisclosure, Holyk[25] made the following purchases:

(6898)

Date of Purchase	*Shares*		*Calls*	
	Number	*Price*	*Number of Shares*	*Cost of Exercise*
11/29/63	50	18		
12/10/63	100	20⅜		
12/12/63			200	21
1/ 6/64			100	23⅝
1/24/64			200	22¼–22⅜
2/24/64			200	24⅛
2/26/64			200	23⅜
3/ 2/64	200	22⅜		
3/16/64			300	23¼
3/17/64	100	23⅞		
3/30/64	100	25⅞		

25. Several of Holyk's purchases of shares and calls were in the name of his wife or in the names of both spouses. Both this court and the Court of Appeals have treated such transactions as purchases in the defendant's name alone.

Prior to the drilling at Kidd 55, Holyk owned no TGS stock, with the exception of 50 shares which he sold prior to December, 1962.

Holyk purchased a total of 550 shares and calls on 1,200 shares. Under the SEC formula, his cost is figured at $34,992.78. The price on April 17, 1964 was $70,656.25, and Holyk will be directed to pay the difference of $35,663.47 to TGS.

Huntington—Defendant Huntington was a lawyer employed to TGS. During the period of nondisclosure, Huntington made the following purchases:

			Calls	
Date of	*Shares*		*Number*	*Cost of*
Purchase	*Number*	*Price*	*of Shares*	*Exercise*
2/26/64	50	23¼		
3/16/64			100	22⅜

Prior to the drilling at Kidd 55, Huntington owned 50 shares of TGS stock.

(6899) Huntington purchased a total of 50 shares and calls on 100 shares. Under the SEC formula, his cost is figured at $3,755.69. The price on April 17, 1964 was $6,056.25, and Huntington will be directed to pay the difference of $2,300.56 to TGS.

Clayton—Defendant Clayton was employed by TGS as an engineer. During the period of nondisclosure, Clayton made the following purchases:

Date of	*Shares*	
Purchase	*Number*	*Price*
11/13/63	200	17¾
2/24/64	400	23⅞
3/ 3/64	100	22¼
3/26/64	200	25
4/ 1/64	60	26½
4/ 2/64	100	26⅞
4/15/64	200	29⅜

Clayton conducted geophysical surveys including surveys on the Kidd anomaly. While he did not participate in the drilling, he spent a great deal of his time at Timmins and at the Kidd 55 segment, and the evidence establishes that he kept himself fully informed. He testified at a pretrial examination that he thought that, with the results of K-55-6, TGS had a potential ore body. By 7:00 P.M. on April 13, 1964, K-55-6 had been drilled to 949 feet, encountering substantial (6900) mineralization. Indeed, no further mineralization was encountered by K-55-6 after that time. Therefore, this court found that Clayton's April 15 purchase violated Section 10(b) and Rule 10b-5, 258 F.Supp. at 286-87, and the Court of Appeals has ruled that his prior purchase also violated these provisions. In view of the evidence, and in order to deter future violations, Clayton will be enjoined from making any further purchases or sales of TGS securities on the basis of material undisclosed information.

Clayton purchased a total of 1,260 shares of stock at a cost of $30,861.94. Under the SEC formula, the price of these shares on April 17, 1964 was $50,872.50, and Clayton will be directed to pay the difference of $20,010.56 to TGS.

Crawford—Defendant Crawford was a lawyer who was employed by TGS in January, 1964, and was appointed secretary of the company and manager of its public relations on February 20, 1964. During the period of nondisclosure Crawford made the following purchases:

Date of Purchase	*Shares*	
	Number	*Price*
4/16/64	600	30⅛-30¼

(6901) On April 15, 1964, Crawford participated with defendant Fogarty and a representative of Doremus & Co. in the preparation of the April 16 press release an-

nouncing TGS's discovery. The evidence establishes that by the evening of April 15 he was fully familiar with the contents of the press release which was to be issued the following morning.

About midnight on April 15, Crawford telephoned his broker and ordered 300 shares of TGS to be purchased at the opening of the market the next morning. He telephoned his broker again at about 8:30 A.M. on April 16 to increase his order from 300 to 600 shares. This court found that Crawford sought to, and did, "beat the news," and that in so doing, he utilized material undisclosed information to his own advantage in violation of Section 10(b) and Rule 10b-5, 258 F.Supp. at 287. In view of the evidence, and on order to deter future violations, Crawford will be enjoined from making any further purchases or sales of TGS securities on the basis of material undisclosed information.

As Crawford has surrendered to TGS, at his cost, the shares which he purchased, the SEC seeks no "other relief," and the court finds no "other relief" to be necessary. (This is also the case with respect to defendants Fogarty and Mollison—See footnote 19.)

(6902) *Defendants Who Accepted Stock Options*

The Court of Appeals ruled that defendants Stephens, Fogarty, and Kline had violated Section 10(b) and Rule 10b-5 in that they accepted options to purchase TGS stock while they possessed material information which they did not disclose to the Stock Option Committee or the Board of Directors. The SEC urges that the court:

1) issue an order enjoining defendants Stephens, Fogarty, and Kline from violating Section 10(b) and Rule 10b-5 in connection with the acceptance

of options to purchase TGS stock while they possess material undisclosed inside information; and

2) issue an order directing TGS to rescind the option to purchase TGS stock granted to defendant Kline, and directing TGS to cancel his option.

Stephens and Fogarty

Defendants Stephens and Fogarty have surrendered their stock options, which have been cancelled by TGS.

This court stated that Stephens and Fogarty "were under a duty to inform the [Stock Option] Committee of material information affecting the issuance of the stock options." 258 F.Supp. at 292.

The Court of Appeals, finding that the information which Stephens and Fogarty possessed was material, directed this court "to consider in its discretion whether to issue (6903) injunction orders against Stephens and Fogarty." *401 F.2d at 864. Judge Hays thought that* "the injunction sought by the Commission [with respect to Stephens and Fogarty] should be granted." *Id.* at 869.

In his summation, Mr. Kennamer, counsel for the SEC, stated:

> "This is to my knowledge the first case where the Commission has brought an enforcement proceeding involving the issuance of stock options—that is, an enforcement proceeding under Rule 10b-5."

The SEC points out that Stephens as Chief Executive, and Fogarty as President, are privy to non-public material information concerning TGS, and assert that "all of the ingredients [for further violations of Section 10(b) and Rule 10b-5] are present." The SEC argues that the failure to inform the Stock Option Committee of material infor-

mation affecting the issuance of the stock options breached a well recognized duty which raises the inference of future violations. Therefore, the SEC seeks an injunction with respect to Stephens and Fogarty.

However, since Stephens and Fogarty have surrendered their stock options to TGS, they have realized no profit by reason thereof. In view of the wide publicity given to this case and the reporting requirements of the 1934 Act, there (6904) seems to be little likelihood that these senior officers of TGS would accept future stock options without disclosing what they know to the Stock Option Committee and the Board of Directors. For these reasons, injunctions will not issue with respect to defendants Stephens and Fogarty.

Kline

This court found that Kline was not in the possession of material undisclosed information at the time he accepted his stock option, stating:

> "Defendant Kline was informed by defendants Stephens and Fogarty at lunch in November 1963 that TGS was conducting explorations in the Timmins area and that the completion of the first drill hole was a favorable development; that it was on the boundary of the TGS property and that TGS was interested in acquiring additional property. He knew no details and his only information came from his superiors." 258 F.Supp. at 291.

The Court of Appeals, finding that the information which Kline possessed was material and that he was under a duty before accepting his option to disclose any material information he may have possessed, "direct[ed] that an order issue rescinding the option granted Kline and that such further remedy be applied against him as may be

proper by way of an order of restitution." 401 F.2d at 864. This is the only instance where the Court of Appeals directed a specific remedy (6905) as to any of the defendants, it having previously stated:

> "Pursuant to a stipulation by all the parties, the question of the appropriate remedies to be applied was deferred pending a final determination whether the defendants or any of them had violated Section 10(b) and Rule 10b-5 and therefore that question is not now before us." *Id.* at 839, n. 1.

While this court believes that the remedy directed with respect to Kline merits reconsideration in the event the matter is again presented to the Court of Appeals, this court is bound by its directions. Therefore, the judgment to be entered will direct Kline to surrender to TGS his stock option heretofore granted on February 20, 1964 covering 4,300 shares of stock, and will direct TGS to rescind and cancel Kline's stock option.

In seeking an injunction against Kline as to future violations, the SEC asserts that "the failure of Kline, who was then Secretary and is now General Counsel of Texas Gulf, to indulge his knowledge concerning the drilling in Timmins to the Stock Option Committee or Board of Directors before accepting stock options, raises the inference that future violations may be reasonably expected, and therefore an injunction should issue." For the reasons stated with respect to defendants Stephens and Fogarty, there seems little likelihood that Kline will accept future stock options without disclosing (6906) what he knows. Therefore, the SEC's application for an injunction is denied.

From what has been said in this opinion, it should be clear that if any of the defendants not here enjoined should again violate Section 10(b) and Rule 10b-5, the remedy of

injunction, in addition to other remedies, would be appropriate.

The foregoing, together with this court's opinion reported at 258 F.Supp. 262, and the Court of Appeals' opinions reported at 401 F.2d 833, constitutes the court's findings of fact and conclusions of law. Rule 52(a), F.R. Civ.P.

The parties may settle final judgments in accordance herewith.

It is so Ordered.

Dated: New York, N.Y.
February 6, 1970.

Dudley B. Bonsal
U. S. D. J.

Appendix A

Judgment of the District Court

(6929)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

[SAME TITLE]

This action having first been brought on for trial before the Honorable Dudley B. Bonsal, United States District Judge, on May 9, 10, 11, 12, 13, 23, 24, 25, 26, 27, 31 and June 1, 2, 3, 6, 7, 8 and 21, 1966, and the Court thereafter having handed down its opinion decision, dated August 16, 1966, and filed on August 19, 1966, constituting the Court's findings of fact and conclusions of law and directing the entry of judgment dismissing the complaint as to all defendants except Richard H. Clayton and David M. Crawford, and said judgment having been entered on August 22, 1966, and said judgment having been affirmed in part and reversed in part by an opinion decision of the United States Court of Appeals for the Second Circuit dated August 13, 1968, and the cause having been remanded for further proceedings, and this action having further come on for hearing before the Honorable Dudley B. Bonsal on October 6, 7 and 8, 1969, and the Court thereafter having handed down its (6930) opinion decision, dated and filed February 6, 1970, which together with such findings of fact and conclusions of law contained in this Court's prior opinion dated August 16, 1966, and filed August 19, 1966, as were sustained by the opinion rendered on August 13, 1968, by the United States Court of Appeals for the Second Circuit, constitutes the Court's findings of fact and conclusions of law, and the Court having found that the defendants Clayton, Crawford, and Texas Gulf Sulphur Company had violated Section 10(b) of the Securities Exchange Act

of 1934 and Rule 10b-5, and the Court of Appeals having ruled that defendants Fogarty, Mollison, Darke, Huntington, Holyk, Stephens, and Kline had violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, it is

ORDERED AND DECREED that defendants Richard H. Clayton and David M. Crawford are enjoined from engaging in the purchase or sale of Texas Gulf Sulphur Company securities on the basis of undisclosed material information relating to Texas Gulf Sulphur Company acquired by said defendants by reason of any relationship with Texas Gulf Sulphur Company or its agents and employees, and it is further

ORDERED AND DECREED that, there being no proper showing of any reasonable likelihood of future violations, injunctive relief against defendants Texas Gulf Sulphur Company, Charles F. Fogarty, Richard D. Mollison, Kenneth H. Darke, Earl L. Huntington, Walter Holyk, Claude O. Stephens, and Harold B. Kline be, and the same hereby is, denied, and it is further

(6931) ORDERED AND DECREED that the defendant Kenneth H. Darke pay over to Texas Gulf Sulphur Company the amount of $90,199.50, with interest at 6% from April 17, 1964, such amount to be held by Texas Gulf Sulphur Company in escrow in an interest bearing account for five years, subject to disposition in such manner as the Court may direct upon application by the Securities and Exchange Commission or other interested person or upon the Court's own motion, at the end of such period such amount as may remain to become the property of Texas Gulf Sulphur Company, except that if Kenneth H. Darke or his estate shall incur liability to any person or entity by reason of his purchases of Texas Gulf Sulphur Company securities

during the period November 12, 1963, through April 16, 1964, or by reason of any recommendation by him to others concerning Texas Gulf Sulphur Company securities during the same period, as a result of a judgment in or settlement of any other action, Texas Gulf Sulphur Company will, at the request of Kenneth H. Darke or his estate, apply said amount toward the satisfaction of such liability, and it is further

ORDERED AND DECREED that the defendant Walter Holyk pay over to Texas Gulf Sulphur Company the amount of $35,663.47 with interest at 6% from April 17, 1964, such amount to be held by Texas Gulf Sulphur Company in escrow in an interest bearing account for five years, subject to disposition in such manner as the Court may direct upon application by the Securities and Exchange Commission or other interested person or upon the Court's own motion, at the end of such period such amount as may remain to become the property of Texas Gulf Sulphur Company, (6932) except that if Walter Holyk or his estate shall incur liability to any person or entity by reason of his purchases of Texas Gulf Sulphur Company securities during the period November 12, 1963, through April 16, 1964, as a result of a judgment in or settlement of any other action, Texas Gulf Sulphur Company will, at the request of Walter Holyk or his estate, apply said amount toward the satisfaction of such liability, and it is further

ORDERED AND DECREED that the defendant Earl L. Huntington pay over to Texas Gulf Sulphur Company the amount of $2,300.56, with interest at 6% from April 17, 1964, such amount to be held by Texas Gulf Sulphur Company in escrow in an interest bearing account for five years, subject to disposition in such manner as the Court may

direct upon application by the Securities and Exchange Commission or other interested person or upon the Court's own motion, at the end of such period such amount as may remain to become the property of Texas Gulf Sulphur Company, except that if Earl L. Huntington or his estate shall incur liability to any person or entity by reason of his purchases of Texas Gulf Sulphur Company securities during the period November 12, 1963, through April 16, 1964, as a result of a judgment in or settlement of any other action, Texas Gulf Sulphur Company will, at the request of Earl L. Huntington or his estate, apply said amount toward the satisfaction of such liability, and it is further

ORDERED AND DECREED that the defendant Richard H. Clayton pay over to Texas Gulf Sulphur Company the amount of 20,010.56, with interest at 6% from April 17, 1964, such (6933) amount to be held by Texas Gulf Sulphur Company in escrow in an interest bearing account for five years, subject to disposition in such manner as the Court may direct upon application by the Securities and Exchange Commission or other interested person or upon the Court's own motion, at the end of such period such amount as may remain to become the property of Texas Gulf Sulphur Company, except that if Richard H. Clayton or his estate shall incur liability to any person or entity by reason of his purchases of Texas Gulf Sulphur Company securities during the period November 12, 1963, through April 16, 1964, as a result of a judgment in or settlement of any other action, Texas Gulf Sulphur Company will, at the request of Richard H. Clayton or his estate, apply said amount toward the satisfaction of such liability, and it is further

ORDERED AND DECREED that defendant Harold B. Kline surrender to Texas Gulf Sulphur Company his stock option heretofore granted on February 20, 1964, covering 4,300 shares of stock, and that Texas Gulf Sulphur Company rescind and cancel such option, and it is further

ORDERED AND DECREED that this Court shall retain jurisdiction for the purpose of the carrying out of this judgment.

Dated: New York, New York
April 16, 1970.

Dudley B. Bonsal
U. S. D. J.

JUDGMENT ENTERED
4/16/70

John Livingston
Clerk

Appendix A

Second Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 914—September Term, 1970.

(Argued May 11, 1971 Decided June 10, 1971.)

Docket No. 35143

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,

v.

TEXAS GULF SULPHUR COMPANY, a Texas Corporation, CHARLES F. FOGARTY, RICHARD D. MOLLISON, RICHARD H. CLAYTON, WALTER HOLYK, KENNETH H. DARKE, DAVID M. CRAWFORD, CLAUDE O. STEPHENS, EARL L. HUNTINGTON and HAROLD B. KLINE,
Defendants-Appellants.

Before:

FRIENDLY, *Chief Judge,*
and WATERMAN and HAYS, *Circuit Judges.*

WATERMAN, *Circuit Judge*:

The within appeals bring before us for the second time the well-known combinations of situations that arose out of Texas Gulf Sulphur's (hereinafter TGS) discovery of rich ore deposits near Timmins, Ontario, and the accompanying stock transactions by the appellants. A detailed description is set forth in our prior opinion, 401 F.2d 833

(2 Cir. 1968) (in banc).[1] In that decision we reversed the district court with reference to its findings, contained in its opinion, 258 F. Supp. 262 (SDNY 1966), as to several of the defendants who had been found below not to have violated Section 10(b) of the Securities Exchange Act of 1934 (hereinafter the Act), 15 U.S.C. §78j(b), and Rule 10b-5, 17 CFR 240.10b-5, promulgated thereunder, and we remanded the case for a hearing on the appropriate remedies to be applied[2] and for the resolution of one undecided question of liability. That hearing has been held, and varying sanctions have been applied. The judgment order entered below (1) enjoined defendants Clayton and Crawford from future violations of Rule 10b-5, (2) denied injunctions against TGS, and defendants Fogarty, Mollison, Stephens, Darke, Huntington, Holyk, and Kline although each was found to have violated 10b-5, (3) required Darke to pay to TGS the profits which he and his tippees made on TGS stock prior to April 17, 1964, (4) required Holyk, Huntington, and Clayton to pay to TGS the profits which each of them made on the TGS stock prior to April 17, 1964,[3] and (5) required Kline's stock option to be canceled. In deciding the issues presented on this appeal, we have grouped the issues for easier discussion.

1. A petition to our in banc court for rehearing was subsequently denied, and two petitions for certiorari, one filed by a party not now in the case, and one by a present appellant, Kline, were denied by the Supreme Court, 394 U.S. 976 (1969).

2. Pursuant to a stipulation by all parties entered into prior to the former appeal, the question of appropriate remedies was deferred for imposition by the district court pending a final determination in appellate courts or upon remand to the district court of whether the defendants or any of them had violated Section 10(b) and Rule 10b-5.

3. Another defendant, Thomas P. O'Neill, was also directed to make similar payments to the TGS escrow fund. This order was entered upon a default judgment, and no appeal has been taken by O'Neill.

A. *TGS—The April 12 press release.*

On April 12, 1964, TGS issued its now famous press release dispelling rumors about the results of its exploratory drilling at Timmins. In our prior opinion we found that this release satisfied all the elements of a violation of Rule 10b-5, with the exception that a hearing was needed in order to determine whether the release was "misleading to the reasonable investor," 401 F.2d at 863, and whether this was caused by a lack of due diligence. On demand Judge Bonsal received both live and deposition testimony from a series of former TGS shareholders who claimed to have sold their stock because of the contents of the April 12 press release. Counsel for TGS objected to this testimony as non-expert opinion testimony of the ultimate fact for decision by the trier of fact, that is, whether the release was misleading. When these objections were overruled, TGS presented its own string of witnesses who testified that in their opinion the release was optimistic and not misleading. On the basis of this contradictory testimony, Judge Bonsal found that the release was misleading to the reasonable investor and that it violated Rule 10b-5. Nevertheless, because there was no showing of any reasonable likelihood that TGS would violate Section 10(b) and Rule 10b-5 in the future, Judge Bonsal denied the SEC's request for an injunction against the corporation.

Upon appeal TGS first contends that the admission of non-expert opinion testimony as to whether the press release was misleading was error. We first note that, contrary to the TGS contention, this testimony did not go to the ultimate issue. The ultimate issue was whether the release was "misleading to the reasonable investor." The testimony of the SEC's witnesses was only that they individually had sold their stock on the basis of the April 12 press release. Cf. *Goldwater* v. *Ginzburg*, 414 F.2d 324, 343 (2 Cir. 1969),

cert. denied, 396 U.S. 1049 (1970). See also Rule 704, Proposed Rules of Evidence for United States Courts and Magistrates (March 1971). There is little doubt that the testimony offered by the SEC was relevant to whether the release was misleading to the "reasonable investor," but its relevance does not mean that the testimony itself was of the ultimate fact. Nor does the claim that the testimony was possibly opinion testimony render it inadmissible. All human perception includes elements of subjective conclusions, and the line between factual and opinion testimony is often undefinable. As stated by Judge Learned Hand in *United States* v. *Cotter,* 60 F.2d 689, 693-694 (2 Cir.), *cert. denied,* 287 U.S. 666 (1932):

> No rule is subject to greater abuse [than the opinion testimony rule]; it is frequently an obstacle to any intelligible account of what happens. Most witnesses will tell their story in colloquial speech which skips the foundations and runs in terms of the "ultimate facts." Ordinarily, they tell it much more plainly in this way, and the warrant for what they say can be perfectly probed by cross-examination.

See also *United States* v. *Petrone,* 185 F.2d 334, 336 (2 Cir. 1950), *cert. denied,* 340 U.S. 931 (1951). Of course, a foundation for opinion testimony must be laid, see Rule 701, Proposed Rules of Evidence for United States Courts and Magistrates (March 1971), and, without question, a foundation was laid here. In such cases, especially where there is no jury, the admission of this kind of testimony lies quite properly within the discretion of the trial court.

TGS also points to a number of facts which it claims makes the SEC's witnesses appear to be "unreasonable," instead of "reasonable," investors. However, these factors go only to the weight of the evidence and were thoroughly explored by TGS upon cross-examination. We conclude

that Judge Bonsal's findings of fact on this issue, after his careful and painstaking weighing of the conflicting testimony in the light of our prior opinion, are not clearly erroneous findings, and we hold, with him, that the press release of April 12 was indeed misleading to the reasonable investor.

TGS next contends that it exercised due diligence in issuing the April 12 press release. However, the district court found, on the basis of the standards laid down in our former opinion, that "the framers of the press release failed to exercise due diligence." 312 F. Supp. at 86. TGS urges that this finding was not an independent finding of fact but a mere adoption of the views in our previous opinion. On this issue TGS introduced no additional evidence on remand, and, without such additional testimony, the fact that the district judge's finding concurred with what TGS claims to have been the view of the in banc court in no way impeaches the independence of the district judge. We find nothing improper in the challenged finding of lack of due diligence.

TGS finally contends that the finding of a violation of Rule 10b-5 for mere negligence in the issuance of the April 12 press release infringes its First Amendment rights.[4] However, the First Amendment deals with the free exchange of ideas and not with commercial "factual" speech. *Valentine* v. *Chrestensen,* 316 U.S. 52 (1942); *Securities & Exch. Comm'n* v. *Wall Street Transcript Corp.,* 422 F.2d 1371, 1379-1381 (2 Cir.), *cert denied,* 398 U.S. 958 (1970); *New York State Broadcasters Ass'n* v. *United States,* 414 F.2d 990, 996-997 (2 Cir. 1969), *cert. denied,* 396 U.S. 1061 (1970); *Banzhaf* v. *FCC,* 405 F.2d 1082, 1101-1102 (D.C. Cir. 1968); *cert. denied sub nom. Tobacco Institute* v. *FCC,*

4. Inasmuch as this issue was not decided by our prior opinion, it is not foreclosed by that decision. It was raised initially in the petition for rehearing, and being bottomed upon an alleged infringement of a constitutional limitation is fully considered here.

396 U.S. 842 (1969); cf. *Curtis Publishing Co.* v. *Butts*, 388 U.S. 130, 150 & n. 14 (1967); *Garrison* v. *State of Louisiana*, 379 U.S. 64, 75 (1964). The April 12 release was a corporate report on the progress of TGS's drilling operations near Timmins, Ontario, and, insofar as the First Amendment's protection of speech is concerned, the report is in the same category as corporate registration statements and prospectuses.

The finding that TGS violated 10b-5 is well-founded and, in our view, unassailable, and though TGS argues that the complaint should be dismissed as to it inasmuch as the injunction the SEC sought was not granted, we affirm the denial of an injunction without dismissing the complaint as a proper discretionary decision by the trial judge under the circumstances. See *Sullivan* v. *Committee on Admissions & Grievances*, 395 F.2d 954 (D.C. Cir. 1969).

B. *Injunctions—Clayton and Crawford.*

Clayton and Crawford were the only defendants enjoined from committing future violations of Rule 10b-5.[5] They contend that this action was discriminatory, particularly because there was no evidence to indicate that their former violations might be repeated. Although we suspect that all the defendants will be circumspect in their future stock transactions, we find that, if any injunctions are to be issued, there is sufficient distinction in Clayton's and Crawford's cases for the district court to single them out. Both of these defendants, having inside information as to the results of the Timmins drilling, bought stock within 24 hours before the news of the ore strike was made public.

5. The injunctions were drawn to cover the circumstances of the violations and enjoined Clayton and Crawford from engaging in the future in any purchases or sales of TGS securities on the basis of undisclosed material information relating to TGS which is acquired by reason of any "insider" relationship with TGS.

Indeed, Clayton and Crawford were the only appellants who had been adjudged violators of Rule 10b-5 by the district court at the first trial of this case. Although the other defendants might have argued that they could not see the "development" of the law which resulted in their having been found by our court to have violated Rule 10b-5, Clayton's and Crawford's conduct was highly suspect even under the principles which the district court applied in its first decision. 258 F. Supp. 262, 285-287 (SDNY 1966).

Crawford again contends, as he contended before, that it was reasonable for him to believe that his stock purchases would be transacted after the public received the full news of the Timmins discovery. However, his present argument is precluded by our former decision which dealt fully with the issue which Crawford would have us now reconsider. 401 F.2d at 856.

In issuing the injunctions against Clayton and Crawford under these circumstances the district judge did not abuse his discretion. See *Securities & Exch. Comm'n* v. *Culpepper,* 270 F.2d 241, 250 (2 Cir. 1959).

C. *Restitution of Profits.*

The district court required Holyk, Huntington, Clayton, and Darke to pay to TGS the profits they had derived (and, in Darke's case, also the profits which his tippees had derived) from their TGS stock between their respective purchase dates and April 17, 1964, when the ore strike was fully known to the public. The payments are to be held in escrow in an interest-bearing account for a period of five years, subject to disposition in such manner as the court might direct upon application by the SEC or other interested person, or on the court's own motion. At the end of the five years any money remaining undisposed of would become the property of TGS. To protect the appellants against double liability, any private judgments against

these appellants arising out of the events of this case are to be paid from this fund.[6]

Appellants contend that, although the district court is given general equity powers under §27 of the Act, the SEC does not have authority under the Act to seek anything but injunctive relief under §21(e), together with whatever ancillary relief is necessary to enforce an injunction, such as the appointment of a receiver. They further contend that the payments required in this case are in essence penalties for they contain no element of compensation to those who may actually have been damaged, and that if it were appropriate to consider the assessment of penalties, it was necessary for the Attorney General to bring a criminal action under §32.

However, despite some legislative history purportedly to the contrary,[7] we do not read §21(e)[8] as restricting the remedies which the SEC can pursue to injunctive relief. The appellants concede that the courts of appeal have upheld the equity power of the district courts to authorize as ancillary relief the appointment of receivers under the Securities Exchange Act of 1934 at the request of the SEC even though no specific statutory authority exists for such action. *Securities & Exch. Comm'n* v. *Bowler*, 427 F.2d 190,

6. According to the district court's opinion, 312 F. Supp. at 93, the settlement orders are to be fashioned after that established with the defendant Coates who is not now an appellant. The relevant terms of the Coates settlement are set forth in footnote 23 of the district court's opinion.

7. S. Rep. 792, 73d Cong., 2d Sess., 1934, p. 22; H.R. Rep. 1383, 73d Cong., 2d Sess., 1934, p. 27.

8. §21(e) (15 U.S.C. §78u(e)) reads:
Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation . . . it may . . . bring an action . . . to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond.

197-198 (4 Cir. 1970); *Securities & Exch. Comm'n* v. *Bartlett,* 422 F.2d 475, 477-478 & n. 6 (8 Cir. 1970); *Lankenau* v. *Coggeshall & Hicks,* 350 F.2d 61 (2 Cir. 1965); *Esbitt* v. *Dutch-American Mercantile Corp.,* 335 F.2d 141, 143 (2 Cir. 1964); *Los Angeles Trust Deed & Mortgage Exchange* v. *Securities & Exch. Comm'n,* 285 F.2d 162, 181-182 (9 Cir. 1960).

Moreover, in other contexts the Supreme Court has upheld the power of the Government without specific statutory authority to seek restitution, and has upheld the lower courts in granting restitution, as an ancillary remedy in the exercise of the courts' general equity powers to afford complete relief. *Mitchell* v. *DeMario Jewelry,* 361 U.S. 288 (1960); *United States* v. *Moore,* 340 U.S. 616 (1951); *Porter* v. *Warner Holding Co.,* 328 U.S. 395 (1946). There is little doubt that §27 of the Act confers general equity power upon the district courts. Appellants' contention is that the SEC is without the authority to request the exercise of these powers. However, as stated in *Mills* v. *Electric Auto-Lite Co.,* 396 U.S. 375, 391 (1970): "[W]e cannot fairly infer from the Securities Exchange Act of 1934 a purpose to circumscribe the courts' power to grant appropriate remedies." While *Mills* was dealing with relief to private litigants, we deem the above statement to be fully applicable in enforcement actions by the SEC. Thus, we hold that the SEC may seek other than injunctive relief in order to effectuate the purposes of the Act, so long as such relief is remedial relief and is not a penalty assessment.

Appellants, of course, contend that the required restitution is indeed a penalty assessment. See *Securities & Exchange Comm'n* v. *Beck,* 430 F.2d 673 (6 Cir. 1970). This contention overlooks the realities of the situation. In our prior opinion we found that these appellants had violated the Act by their purchases of TGS stocks before there had been a public disclosure of the ore discovery. Restitution

of the profits on these transactions merely deprives the appellants of the gains of their wrongful conduct. Nor does restitution impose a hardship in this case. The lowest purchase price of any of the transactions here was $17.75 per share paid by Clayton on November 15, 1963. The mean average price of the stock on April 17, 1964, has been stipulated by the parties to be $40.375 per share. By May 15, 1964, the stock was selling at $58.25 per share. The court's order requires only restitution of the profits made by the violators prior to general knowledge of the ore strike on April 17, 1964, and, in effect, leaves the appellants all the profits accrued after that date. It would severely defeat the purposes of the Act if a violator of Rule 10b-5 were allowed to retain the profits from his violation. The district court's order corrects this by effectively moving the purchase dates of the violators' purchases up to April 17, 1964.

As to the requirement that Darke make restitution for the profits derived by his tippees, admittedly more of a hardship is imposed. However, without such a remedy, insiders could easily evade their duty to refrain from trading on the basis of inside information. Either the transactions so traded could be concluded by a relative or an acquaintance of the insider, or implied understandings could arise under which reciprocal tips between insiders in different corporations could be given.

Finally, appellants contend that the order is punitive because it contains no element of compensation to those who have been damaged. However, as the New York Court of Appeals in *Diamond* v. *Oreamuno*, 24 N. Y. 2d 494, 499, 301 N. Y. S. 2d 78, 81-82 (1969), recognized, a corporate enterprise may well suffer harm "when officers and directors abuse their position to obtain personal profits" since "the effect may be to cast a cloud on the corporation's name, injure stockholder relations and undermine public regard for the corporation's securities." Although the sellers of TGS stock who sold before April 17, 1964, may have a

higher equity than TGS to recover from appellants the wrongful profits appellants obtained, this fact does not preclude conditional compensation to TGS. Nor, as the appellants appear to imply, is the district court precluded from applying a state concept of harm to the corporation.

We conclude that the requirement of restitution in this case was a proper exercise by the trial judge of the district court's equity powers.

D. *Kline—cancellation of stock option.*

In our prior opinion we directed the district court to cancel Kline's stock option to rectify his violation of Rule 10b-5 (the other four stock options had been voluntarily canceled or were otherwise not in issue). 401 F.2d at 857. Although, as with the requirement of restitution considered above, the district court had the power to order the cancellation of the option so as to effect the purposes of the Act, we confess our error in instructing the district court without further proceedings there to apply this remedy inasmuch as the question of remedies was not before this court on the prior appeal. By stipulation of the parties, the question of appropriate remedies was deferred pending a final determination on whether Rule 10b-5 had been violated. See 401 F.2d at 839 n. 1. Hence, none of the parties argued or briefed the question of remedies on the last appeal. On remand, the district court, confronted with our unambiguous instruction, ordered the cancellation of Kline's stock option without holding a hearing on the issue. Thus, Kline has been deprived of his day in court on the question of an appropriate remedy, and we must remand Kline's case for a hearing on this question.

Kline also urges that his admittedly limited knowledge of the drilling results at the time he accepted the option was not material even under the definition of "materiality" we laid down in our prior decision. While we agree that Kline's lack of dealing in TGS stock would seem to support

his claim of limited knowledge, thus making the question an extremely close one factually, this issue was fully before the in banc court and no sufficient reason is advanced why this court's prior determination should be changed. However, Kline is not precluded from arguing the borderline nature of his violation upon remand insofar as it may bear on the question of the appropriate remedy to be applied to him.

E. *Crawford—The right to oral argument before an in banc court.*

Crawford urges that he was denied both his statutory rights and his constitutional right to procedural due process on the last appeal because oral arguments were not allowed before at least a quorum of the in banc court. In support of this contention Crawford relies heavily on 28 U.S.C. §46(c)[9] and the partial interpretation of that section given in *United States* v. *American-Foreign S.S. Corp.*, 363 U.S. 685 (1960), where it was held that the words "determined" and "active" were to be used in their literal sense in deciding the eligibility of court of appeals judges to sit in an in banc court. Crawford urges that the word "heard" should likewise be given a literal interpretation and, therefore, he claims that oral arguments are required before at least a quorum of the in banc court.

We point out that the Supreme Court cautioned at the very beginning of its opinion in *American-Foreign S.S. Corp.* that "[t]he question to be decided . . . is a narrow one." In concluding that only judges in "active service" were eligible to sit on in banc panels, it specifically referred to its earlier decision in *Western Pacific R. Corp.* v. *Western*

9. §46(c) reads:

> Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court *in banc* is ordered by a majority of the circuit judges of the circuit who are in regular active service.

Pacific R. Co., 345 U.S. 247 (1953), as authoritative on the legislative history and intent of §46(c). Thus, because the present question of hearing procedure is different from the narrow question of judicial eligibility in *American-Foreign S.S. Corp., we turn to Western Pacific.*

As explained in *Western Pacific*, §46(c) was merely a ratification of the earlier decision in *Textile Mills Securities Corp.* v. *Commissioner*, 314 U.S. 326 (1943), in which the Supreme Court held that the courts of appeals had the power to hear cases in banc. As stated in *Western Pacific*:

> §46(c) is not addressed to litigants. It is addressed to the Court of Appeals. It is a grant of power. It vests in the court the power to order hearings en banc. It goes no further. 345 U.S. at 250.

Thus, §46(c) does not confer rights upon the litigants:

> The statute deals not with rights, but with power. . . . Because §46(c) is a grant of power, and nothing more, each Court of Appeals is vested with a wide latitude of discretion to decide for itself just how that power shall be exercised. 345 U.S. at 259.

American-Foreign S.S. Corp., upon which Crawford relies, concerned solely a question of "power," the eligibility of a circuit judge not in active service to sit on an in banc panel. In marked contrast to this, when the Supreme Court was faced with a procedural interpretation of §46(c) in *Shenker* v. *Baltimore & Ohio R.R. Co.*, 374 U.S. 1 (1963), it gave broad leeway to the Court of Appeals to render its own interpretation of the word "majority" in §46(c). It specifically referred to the problem as one of "internal administration." 374 U.S. at 5.

Because §46(c) pertains only to our power to convene in banc panels, we do not interpret it as requiring that a convened in banc court must listen to oral arguments. The decision to grant or not grant oral arguments on cases in

banc is purely a matter of discretion, and the court may limit the issues to be presented to it and the method of advancing the arguments to it.

Crawford also contends that the lack of oral arguments before the in banc court deprived him of due process under the Fifth Amendment. As to this contention, it seems obvious that the power to deny a rehearing clearly encompasses the power to limit a rehearing so long as the parties are treated equally. We find no merit to this claim.[10]

F. *Fogarty, Mollison and Stephens.*

The trial court on remand found that under the circumstances no relief needed to be ordered against these three defendants. Because no relief was granted, these defendants urge that the complaint should have been dismissed as to them and the recitation of their violations of the Act stricken from the judgment. We disagree. Because of the nature of the violations, it was within the district court's discretion to deny injunctive relief without dismissing the complaint. See *Sullivan* v. *Committee on Admissions and Grievances,* 395 F.2d 954 (D.C. Cir. 1969).

G. *Conclusion.*

In summary, therefore, we affirm the judgment below as to each of the appellants, with the exception that the order cancelling Kline's stock option is reversed and his case is remanded for a hearing on the appropriateness of that remedy.

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10. We also note that the Fifth Circuit has exercised a discretion to dispose of oral arguments at the original "hearing" before three-judge panels. Rule 18, 5 Cir.; see *Isbell Enterprises, Inc.* v. *Citizens Casualty Co. of New York,* 431 F.2d 409, 410-414 (5 Cir. 1970). Inasmuch as the validity of this practice is not now before us, we do not intend that anything stated in the present opinion be construed as approving or disapproving the denial of oral arguments at the initial "hearing" on appeal, despite the existence of authority in support of such a practice. See *FCC* v. *WJR,* 337 U.S. 265, 276 (1949); Davis, Administrative Law §7.07 at 434.

Appendix A

Judgment of the United States Court of Appeals for the Second Circuit

UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the tenth day of June, one thousand nine hundred and seventy-one.

Present:

HON. HENRY J. FRIENDLY, *Chief Judge,*
HON. STERRY R. WATERMAN,
HON. PAUL R. HAYS, *Circuit Judges.*

[SAME TITLE]

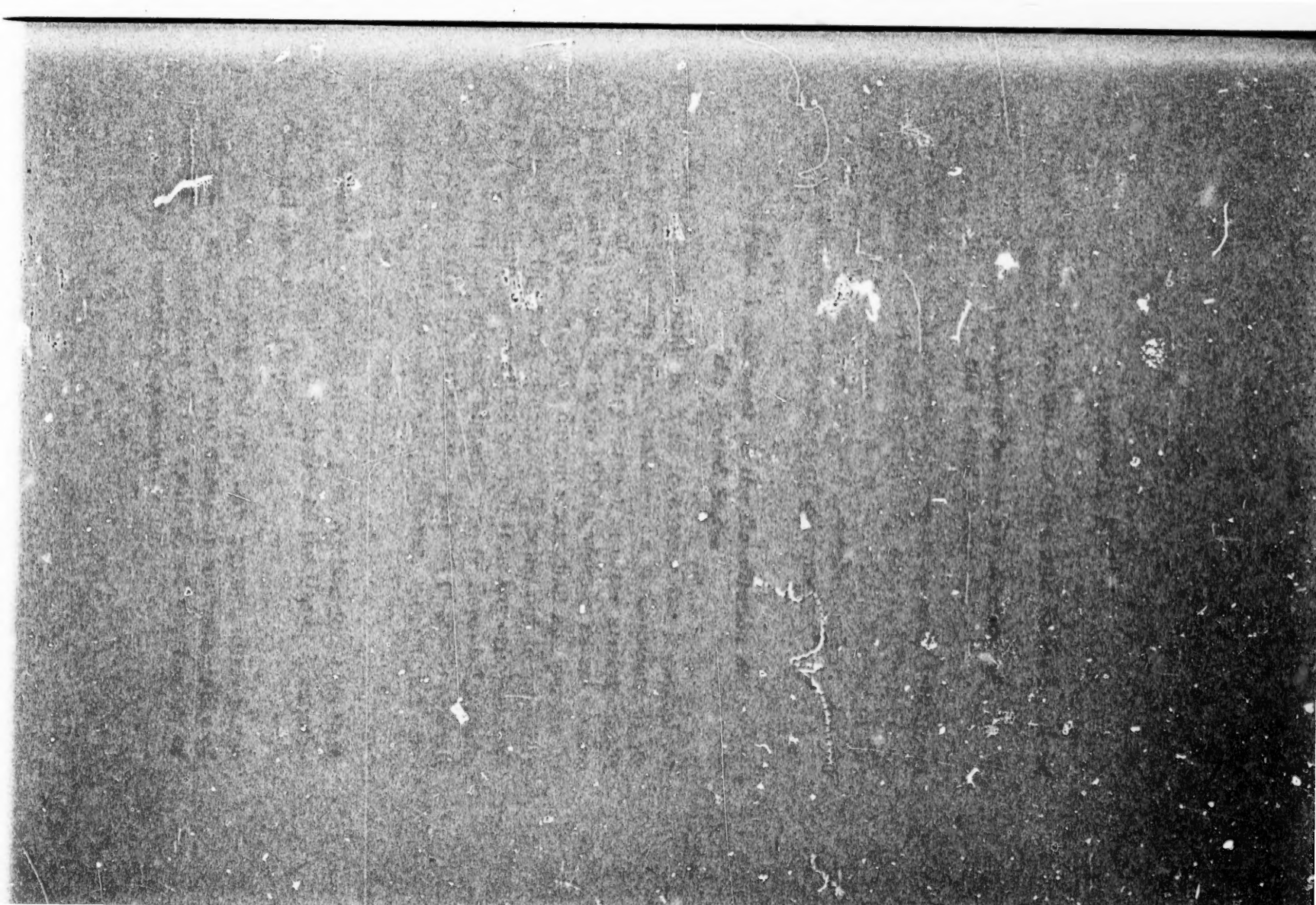
Appeal from the United States District Court for the Southern District of New York.

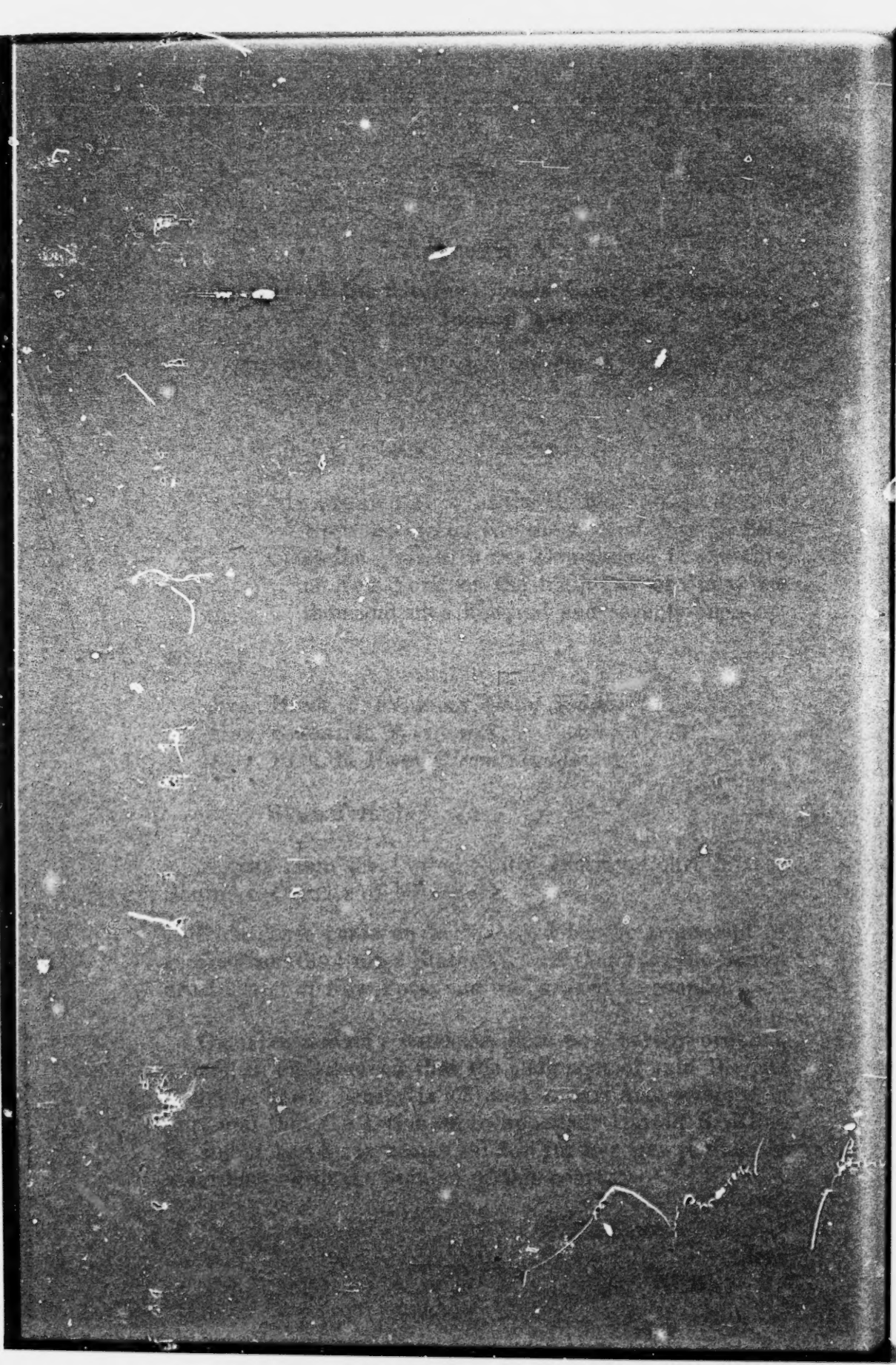
This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed in part and reversed in part and that the action as to appellant Harold B. Kline be and it hereby is remanded for further proceedings in accordance with the opinion of this court.

A. DANIEL FUSARO
Clerk

/s/ W.B.





Appendix B

Constitutional Provisions, Statutes and Rules Involved

FIRST
~~Fifth~~ *Amendment to the Constitution of the United States*

"Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances."

FIFTH
~~First~~ *Amendment to the Constitution of the United States*

"No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.'

Securities Exchange Act of 1934, Section 10(b), 48 Stat. 891, 15 U.S.C. §78j: "Regulation of the Use of Manipulative and Deceptive Devices":

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • •

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Securities Exchange Act of 1934, Section 21(e), 48 Stat. 900, 15 U.S.C. §78u(e): "Investigations; Injunctions and Prosecution of Offenses":

"(e) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States, the District Court of the United States for the District of Columbia, or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this title."

Securities Exchange Act of 1934, Section 27, 48 Stat. 902, 15 U.S.C. §78aa: "Jurisdiction of Offenses and Suits":

"Sec. 27. The district courts of the United States, the District Court of the United States for the District of

Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code as amended (U.S.C. title 28, secs. 225 and 347). No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against it in the Supreme Court or such other courts."

Securities Exchange Act of 1934, Section 32(a), 48 Stat. 904, 15 U.S.C. §78ff: "Penalties":

"Sec. 32. (a) Any person who willfully violates any provision of this title, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this title, or any person who willfully and knowingly makes, or causes to be made, any statements in any application, report, or document required to be filed under this title or any rule or regulation thereunder or any undertaking contained in a

registration statement as provided in subsection (d) of section 15 of this title, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation."

Rule 10b-5, 17 C.F.R. 240.10b-5: "Employment of Manipulative and Deceptive Devices":

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

> "(1) to employ any device, scheme, or artifice to defraud,
>
> "(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> "(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

Rule 12b-2(j), 17 C.F.R. 240.12b-2(j): "Definitions":

"Unless the context otherwise requires, the following terms, when used in the rules contained in this regulation or in Regulation 13A or 15D or in the forms for statements and reports filed pursuant to sections 12, 13 or 15(d) of this act, shall have the respective meanings indicated in this rule:

• • •

(j) *Material.* The term 'material,' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before buying or selling the security registered."